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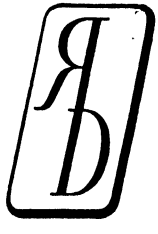
by

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Life Insurance *Property Insurance*

THIRD EDITION



1951

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PREFACE TO THIRD EDITION

IT USED to be said at the laying of the keel of a battleship that even though the plans represented the very latest developments in naval science and construction the battleship would, of necessity, be obsolete even before it was launched. This was true because developments in the field were progressing at such a rate that more advanced techniques were certain to be in evidence even before the ship could be off the ways.

The same may be said of an insurance text, particularly if the text undertakes to give body to the framework of theory with practical illustrative material. An author, therefore, if he wishes to keep his text current as long as possible, is faced with the choice of eliminating illustrative material or reducing it to an absolute minimum. To do this he unquestionably curtails the usefulness of the book. The other alternative is to include sufficient illustrative material for the needs of a comprehensive text and at the same time accept the attendant risks.

The selected references that appeared at the ends of the chapters in the previous editions have been omitted. Bibliographies such as those prepared by the Insurance Group of the Special Libraries Association, taken together with the regularly published *Insurance Book Reviews* of that group, make available to the student a reading list that is both comprehensive and current. Because it was believed that the further inclusion of bibliographical material in the text had a limited usefulness the selected references have been eliminated.

Since a textbook is designed for teaching purposes and not as an underwriting manual, it is the author's conviction that it is not so important for the student commencing the study of insurance to know whether a policy exception is the one current at the moment as it is for him to know that the exception is typical of those to be found in the type of policy under consideration. It was with this point in view that the original edition of *General Insurance* was prepared, and this point of view has been maintained in the first as well as the current revision.

In the past few years the changes in the insurance business have not been limited to minor policy adjustments. New standard forms

have made their appearance, and in some fields the trend of development has taken new direction. It is with the thought of bringing *General Insurance* up to date both as to the minor changes, which are of less importance, and as to the major developments, which are of greater importance, that the present edition is prepared. The general plan of the book remains unchanged.

The reception of the book during the decade following its first publication has been most gratifying. The author wishes to express his continued obligation to all who have offered words of advice as well as evidences of encouragement. It is his hope that the book may continue to serve a useful purpose in the field of insurance education.

J. H. M.

BANGOR, MAINE
January, 1947

PREFACE TO SECOND EDITION

IN PREPARING this revision of *General Insurance* the author has varied from the original plan but little. Perhaps the outstanding development in the field of insurance since *General Insurance* first appeared has been the increasing activity of the government. The author felt it necessary to orient the business of insurance with reference to this activity.

Another development has been the outbreak of World War II. While all insurance is effected to a greater or less degree by the outbreak of hostilities, certain forms feel the impact with greater force than do others. To this end, the author has not undertaken to elaborate upon the war exclusion clauses in all the forms of insurance but has felt that in the field of marine insurance war hazards are so important as to deserve something more than passing attention.

The author is grateful to those who have offered suggestions and who have written expressing their thoughts and ideas with relation to *General Insurance.* The author has given these suggestions careful thought and where possible without changing the general plan of the book has acted upon them.

The revised edition of *General Insurance* is offered with the hope that the book may continue its usefulness in the field of insurance education.

J. H. M.

BANGOR, MAINE
May 15, 1942

PREFACE TO FIRST EDITION

WHEN first introduced in the colleges and universities, courses in insurance were held by many to be of interest only to those students who contemplated making the business of insurance a life's work. This attitude has so changed that today it is believed that a comprehensive knowledge of insurance principles and coverages is part of the necessary equipment of every businessman. Insurance courses therefore now attract more general attention.

It is recognized that everyone, regardless of business or profession, is faced from time to time with the necessity of making important decisions concerning an insurance program. To meet the needs of the greatest number, many educational institutions are offering a survey course in insurance, covering the entire field in a single semester, or at the most in a single year. It is hoped that this text will facilitate teaching in such courses.

Heretofore emphasis has been placed upon a difference in texts designed for the buyer of insurance and those planned for the student who plans to enter the business of insurance. But inasmuch as the successful seller of insurance must thoroughly understand the needs of the insurance buyer before he can undertake to propose a program for his customer, the basic foundational information of both groups is essentially the same. Those who plan to enter the field of insurance selling will, of course, continue their study in specialized courses.

Since the book is designed for use in college survey courses in which the student doubtless is making his first contact with the field, experienced insurance men will find it to contain much that is elementary. Moreover, some of the more difficult and advanced phases of the various branches of insurance, that might reasonably be expected in a text for college students, had to be omitted as belonging more properly in specialized texts limited to a single field and designed for advanced courses. If this present text assists the student to gain a sufficient understanding of the principles and coverages of insurance to enable him intelligently to plan a satisfactory program of insurance for his personal needs or his business responsibilities, it will have accomplished its purpose.

In the preparation of the work the author has drawn upon some years of teaching experience as well as many years of experience in the business of insurance. He is indebted to associates and friends, both among teachers and businessmen, for suggestions and assistance. Executives of insurance companies have not merely generously supplied manuals, rule books, house organs, and other publications but have supplemented printed matter with personal letters. Important insurance libraries have co-operated splendidly.

In planning a text for an introductory survey course of this type, in order to keep the text within reasonable limits and prevent its becoming unwieldy, the major problem is one not of inclusion but of exclusion. In this book, therefore, statements that are applicable to all the major branches of insurance have been used as introductory material before the various divisions of the field are considered as separate branches.

Because fire insurance is more or less familiar to almost everyone, this form is used as a point of departure for a consideration of the specific coverages, and the fire insurance contract is considered in some detail. In the subsequent considerations of other types of insurance, discussion is limited to characteristics peculiar to the particular contract under discussion, except when the contracts are basically different and require fuller consideration. This explains in part the apparently slow movement of the early chapters of the book and the quickened pace of the later chapters.

The lists of suggested reading references appended to the various chapters constitute only a partial acknowledgment of indebtedness to the various writers in the different fields. A complete list would include many hundreds of articles that have from time to time appeared in the leading insurance publications but which were not listed for lack of space.

It is a pleasure gratefully to acknowledge indebtedness to so many sources and to express to all deep and sincere appreciation.

J. H. M.

BANGOR, MAINE
March 1, 1936

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PART I

INTRODUCTION

CHAPTER I

HISTORICAL BACKGROUND

EVOLUTIONARY Trends. Through the agency of insurance the burden of risk is transferred from the shoulders of the individual to whom it attaches to a carrier willing to assume it. In its simplest form, insurance undertakes to protect the insured against pecuniary loss that is the outgrowth of the happening of some unfavorable contingency.

Long before the business of insurance became established as a commercial enterprise, the germ of the idea made its appearance. The growth of the idea to an institution of the size and importance of the business of insurance today is the outgrowth of a long period of evolution. Well said of a branch of the business, this statement admirably applies to the idea as well:

> This great institution represents a growth and development from simple beginnings. It did not, like Athena, spring fully formed and fully armed from the head of any one person. It has attained its present impressive proportions through years of effort; through the patient and wise planning of men of vision and of faith. It has steadily grown in power for good, "broadening down from precedent to precedent," until today it occupies an important, an essential, place in the economic and social life of the nation.[1]

It was not the outgrowth of any legislative action.[2] Its history is part of the history of commerce and navigation.[3] It has been described as the last term in the evolution of various legal devices invented to provide against the risks of the sea.[4] The origin of the idea is not easily located. It probably made its appearance with the earliest develop-

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[1] McClench, W. W., *Betterment of Life Insurance Service* (New York: Association of Life Insurance Presidents, 1919), p. 5.

[2] Holdsworth, W. S., *The Early History of the Contract of Insurance,* 17 Columbia Law Review 85.

[3] Hoffman, F. L., *Insurance Science and Economics* (New York: Spectator Co., 1911), p. 144.

[4] Holdsworth, W. S., *op. cit.,* quoting from Lefort's introduction to Bensa's work on insurance: "Le contrat d'assurance maritime n'est pas dû au génie d'un legislateur; c'est le dernier terme d'une série d'évolutions par lasquelles s'est manifestée l'idée de prévoyance dans la lutte contre les fortunes de mer, lutte qui devait être d'autant plus vive que de jour en jour augmentait l'importance des vies et des intérêts confiés aux caprices des flots" (Bensa, E., *Histoire du Contrat d'Assurance au Moyen Age,* translated from the Italian by J. Valery [Paris, 1897], p. vi).

ment of commerce, though not until comparatively recent years did the institution become of great commercial importance.

Insurance Idea Develops in Connection with Transportation Hazards. So far as extant records furnish evidence, loans of the type known during the Middle Ages by the terms "bottomry" and "respondentia" served as the earliest means in general commercial use to effect a shifting of the burden of risk. Evidence from Babylon, by no means conclusive, warrants a presumption that a contract similar to bottomry was known to the merchants of that country and may have originated with their commercial expansion as early as 4000–3000 B.C.[5] The evidence from India that bottomry was practiced by the Hindus in 600 B.C. or earlier intimates that the insurance feature of the contract was understood.[6] It is well established that the contract was well understood in ancient Greece as early as the fourth century before the Christian Era, and was used in connection with maritime loans.[7] The same form of loan agreement was adopted by the Romans in their commercial practice and, following them, by the maritime nations of Europe during the period of the Middle Ages. Maritime interest furnished a most profitable source of income to the money lenders of ancient Greece, and a bottomry contract developed that in its essentials corresponded to the contract of modern times.[8] A well-defined procedure for effecting a bottomry agreement was developed. Contracts were formed by drawing up articles of agreement and depositing a record of them with a money changer.[9] The form

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[5] Trennery, C. F., *The Origin and Early History of Insurance, Including the Contract of Bottomry* (London: P. S. King & Son, Ltd., 1926), pp. 5 ff.

[6] Walford, C., *Insurance Cyclopedia* (London: Charles and Edwin Layton, 1871–78), Vol. I, p. 334.

[7] Trennery, *op. cit.*, chap. v.

[8] The insurance element in this type of loans agreement is to be found in the provision that, if the security upon which the money is advanced is lost or destroyed, then the debt is canceled. Thus, if a cargo of grain were to be shipped from one port to another, the owner of the grain could borrow its value from a money lender, paying a rate in excess of the current interest rate. If the cargo is lost, its owner is indemnified because he need not repay the loans, and the loss rests upon the money lender. According to the custom developed by the ancient Greeks, the ship or the cargo was made the security for the money lent. There is a possibility that the money received from passage and freight was likewise pledged as security. Loans were made, so far as can be determined, most frequently upon the cargo, less frequently upon the ship, and least often, if at all, upon the money received for passage or freight. Because the lender assumed the risk of loss, the borrower, besides securing capital for use in his undertakings, enjoyed the benefits of a contract that in fact provided insurance protection.

[9] Boeckh, A., *The Public Economy of the Athenians*, translated by A. Lamb (Boston: Little, Brown & Co., 1857), chap. xxiii.

of agreement developed is a most complete and interesting document, and clauses and conditions that were incorporated therein have been retained and included as among the most essential features of the modern marine insurance policy. Fortunately, there is in the oration of Demosthenes against Lacritus a complete agreement, and others have been preserved in part. These documents may be said to represent the seed of the modern insurance contract.[10]

Bottomry in Ancient Rome. The bottomry contract was widely known and extensively used by the ancient Romans in the ordinary course of business, and the contract is in its essentials the same contract as that developed by the Greeks.[11] *Trajeticia pecunia,* the term applied in Roman law to money lent on bottomry, referred to money lent for mercantile adventure beyond the sea, with repayment conditional upon the safe arrival of the security at its destination.[12] The insurance element in the agreement was clearly defined, and the risk assumed by the creditor was considered as a sufficient reason to warrant a higher rate than the usual rate of interest. Nor did the Romans confine this type of contract to marine undertakings alone, but used it in numerous cases where perils of the sea were not a factor.[13]

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[10] The question naturally presents itself as to whether any of the ancient peoples had provided themselves with means of indemnification in the event of loss by fire. Relying upon a paper read before the Insurance and Actuarial Society of Glasgow in 1881, quoted by Relton in his excellent work on the history of fire insurance in Great Britain during the seventeenth and eighteenth centuries, the statement is frequently made that the beginning of fire insurance is to be found in the towns and districts of Assyria and the East more than 2,500 years ago. Since its appearance in Relton's book, either through further quotation, or the repetition of the subject matter in subsequent works, the statement has had a wide circulation. It is used as a basis for the assertion now frequently made that a form of mutual fire insurance, through compulsory assessment, was in operation in Assyria at this early date.

Notwithstanding the frequency with which this statement is met in insurance literature, reference to the large number of business documents from Babylonia and Assyria furnishes no evidence of any kind of insurance, and makes inevitable the conclusion that the statement as originally made was based upon faulty information. The improbability of the correctness of the original conclusion is emphasized when it is recalled that in 1881, when the statement originally appeared, the decipherment of Assyrian cuneiform had not progressed far enough to make possible with any degree of certainty the conclusion at that time presented. Until further information is forthcoming, therefore, the statement frequently met that mutual fire insurance in the form of compulsory assessments was known and practiced by the early Assyrians should be recognized as extremely doubtful.

[11] Duer, J., *The Law and Practice of Marine Insurance* (New York: John S. Voorhies, 1845), Vol. I, pp. 20–22.

[12] Roby, H. J., *Roman Private Law* (Cambridge: University Press, 1902), Vol. II, p. 75.

[13] An instance is cited of a loan made to a fisherman for the purpose of purchasing apparatus, repayment of the loan depending upon the catch of fish. There is another instance where money was lent to an athlete for training purposes, repayment to be

***Collegia* and Life Insurance.** Of particular interest, because possessing many of the characteristics of life insurance as written today by the fraternal or beneficial societies, was the practice at Rome of organizing burial societies whose functions were, among others, the payment of the *funeraticum,* or death benefit, upon a member's decease.

The *collegia tenuiorum* was a Roman guild organization of free wage earners and slaves employed in the shops and households. The death benefit was designed to provide a fund for the burial of members who might otherwise be deprived of rites that to them were deemed most necessary.[14]

Income for these organizations was derived from two main sources: the initiation fee and a system of monthly dues. Dues were paid directly to the treasury, and out of this fund all expenses of the organization were paid. Penalties were imposed for nonpayment of dues with a grace period before failure to pay operated to cancel the member's benefits.[15] There is no evidence that these organizations rendered assistance in time of sickness or other need, though ultimately, in addition to furnishing a fund for burial and funeral rites of the deceased member, there was also a sum available for the heirs.[16]

The Guilds as Insurers. During the Middle Ages, mutual insurance received an impetus with the development of the guilds. Attempts to trace the origin of the guilds from the Roman *collegia* have not been altogether successful. There is reason to believe that in those countries where the Roman influence had manifested itself the guilds reflected the influence of the *collegia,*[17] though they more probably may be traced to no single source.[18]

Besides concerning themselves with almsgiving and the care and burial of the dead, the guilds established insurance funds for the

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made by him in the event he won at the contests. In each of these cases the borrower was insured against loss arising out of disbursements made in preparation for an undertaking that might turn out unsatisfactorily.

[14] Rostovtzeff, M. A., *The Social and Economic History of the Roman Empire* (Oxford: Clarendon Press, 1926), p. 178.

[15] Abbott, F. F., *Common People of Ancient Rome* (New York: Charles Scribner's Sons, 1912), p. 225.

[16] Waltzing, J. P., *Etude Historique sur les Corporations chez les Romans* (Louvain: Charles Peters, 1895), pp. 301, 303, 321.

[17] Walford, *op. cit.,* Vol. V, p. 342.

[18] Seligman, E. R. A., "Mediæval Guilds of England," *Publications of the American Economic Association,* Vol. XI (1887–88), p. 9.

benefit of the members.[19] This insurance feature was usually made effective through regular payments by members into a common fund out of which disbursements were made to those suffering losses from certain specified disasters. The more common of these included fire, flood, or robbery, though the guild system of indemnity was eventually extended to cover most of the risks which attached to the enterprises of the time.[20]

There seems to be no evidence that the guilds in England developed into distinct insurance associations, nor that any fire insurance association, following the decline of the guilds, had become well established previous to the London fire of 1666.

First Insurance Ordinances. During the Middle Ages bottomry continued to serve as the vehicle for risk bearing. The first definite ordinances concerning insurance as a specialized contract come from Spain. The magistrates of Barcelona on four separate occasions during the fifteenth century promulgated ordinances dealing directly with the subject of insurance, dating respectively 1436, 1458, 1461, and 1484.[21] These laws are designed, not to make provision for effecting insurance, but rather, recognizing its existence, to secure its full benefits for the community, to prevent over-insurance, and to eliminate fraudulent transactions.[22]

With the ordinances of Barcelona in the fifteenth century marine insurance became an established institution. By way of evidencing the extent of its use, there are records of decrees bearing upon the subject of insurance from Venice that in point of time antedate the earliest recorded ordinances of Barcelona. The Venetian decrees, while not strictly insurance regulations, in the sense of making provisions regulating the contract, as do the Spanish ordinances, are

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[19] Smith, T., *English Gilds* (London: N. Trubner & Co., 1870), p. xxxvi.

[20] Relief not unlike the accident and health insurance of modern times was provided in the event of need in old age, at the loss of sight or limb, upon becoming deaf, dumb, or becoming afflicted with a serious malady such as leprosy. There were guilds which rendered assistance to those who lost cattle, or for the fall of a house. Others provided relief in the case of shipwreck, in the case of imprisonment, or for the legal defense of members who became involved with the law. Sometimes provision was made for gifts to the young people so that they could get started in the world, and dowries were provided for young women. Assistance was frequently rendered in pecuniary difficulties, sometimes as special instances, and in others as a regular feature of the guild benefits. In short, the insurance feature of the guilds was expanded to meet the needs of the times, and the manner of accomplishment cannot but excite admiration.

[21] Duer, *op. cit.*, Vol. I, p. 41.

[22] Martin, F., *The History of Lloyds* (London: Macmillan & Co., Ltd., 1876), Vol. I, p. 35.

nevertheless concerned with the subject matter of insurance, and demonstrate beyond a doubt the existence of an insurance system among the Venetians at the dawn of the fifteenth century.[23]

It is not to be supposed that the practice of insurance as evidenced by the records of Spain and Italy was limited to the Mediterranean. A mercantile practice of Venice was certain to find its way to England because the Italians, or "Lombards," as they were known, had already secured a strong foothold in England and were competing commercially with the powerful Hanseatic League of the North.[24] Presumably by this time marine insurance had spread through the lanes of commerce and was well known and commonly used by the merchants and shipowners throughout the whole of continental Europe. The more cumbersome bottomry contract had been supplanted by the contract of indemnity.[25]

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[23] Hopkins, M., *A Manual of Marine Insurance* (Philadelphia: J. B. Lippincott & Co., 1867), p. 20.

[24] While the date of the introduction of the insurance contract cannot be accurately fixed, the hypothesis that it originated in Italy deserves attention. During the Middle Ages the spread of commercial institutions was from the south to the north. As early as the twelfth century, papal emissaries had penetrated the remote parts of northwestern Europe and were instrumental in disseminating the financial ideas of the south. Italian merchants followed the traveling markets or fairs of northern France, Germany, and England; and they were accompanied by Lombard money changers. Expanding their operations throughout the Continent during the thirteenth century, the Lombards became powerful financiers, and their influence was great. In the hands of their colony in London rested the foreign trade of the kingdom, and to them tradition ascribes the introduction of insurance to England.

Added to tradition is a powerful argument from etymology. The word "policy" which is used today to designate the name of the written instrument containing the contract comes from the Italian. The word in the English language, or in any other language than the Italian, has no meaning save that arbitrarily ascribed to it. *Polizza,* the Italian word from which "policy" is derived, is used as the name of a contract in writing that furnishes evidence of or creates a legal obligation. Hence its application to the insurance contract by the Italians was perfectly correct, though its use was by no means limited to such contracts. The term has been carried out of the Italian as a name for the insurance contract and leads to the presumption that the insurance idea was introduced by the Italians and the contract designated by them a *polizza.*

[25] The oldest treatise in a modern language dealing with the subject matter of insurance is that entitled *Le Guidon de la Mer,* published in 1671 by Cleirac, a learned French jurist, in the second part of his work on the uses and customs of the sea (*Us et Coutumes de la Mer*). No account is given by Cleirac of the author or origin of the work. Cleirac, in his commentary upon the first article of *Le Guidon,* gives us the earliest statement in any work on insurance concerning its origin. He asserts that insurance was invented by the Jews when they were expelled from France by Philip Augustus in 1182 and sought and found refuge in Italy. This opinion is founded, he states, upon a statement in the universal history of Giovanni Villani, who according to Dr. Duer died at an advanced age in 1348, "the most justly celebrated of the early Florentine historians." It is the theory that the Jews made payments called presents to insurers who assumed, as far as the shipments were concerned, all the risks of the

The Individual Underwriter. The arrival of the sixteenth century found the practice of marine insurance general and its principles well understood in the maritime nations. For many years after the turn of the century, insurance underwriting had not become a specialized business but was carried on by merchants who, from time to time, committed themselves to risks by subscribing to policies as a side line to their other affairs.

In England the early policies were issued in this manner; and, just as the insurers were merchants, so the business of insurance was in the hands of the sworn brokers who acted as the merchants' agents in buying and selling goods. It was the custom, though not followed in every instance, to have the policies drawn up and attested by a notary.[26] Lombard Street seems to have been the headquarters for merchants engaged in taking marine risks, though there appears to have been no particular control or centralization of facilities.[27]

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voyage. The Lombards, who were spectators of the transactions, are believed to have preserved the forms of the instruments used and afterwards adapted them to their own commercial transactions.

Another hypothesis was advanced by Vilagut, a doctor of law, in his treatise *De Usuris* published in Venice in 1589. The *Corpus juris canonici* prohibited interest, though certain exceptions were permitted. Such was the situation in bottomry loans where the lender assumed the risks of the venture. In 1243 a decree was promulgated by Pope Gregory IX declaring such loans prohibited as usurious. Aluzet, a French writer, commenting upon this decree, states that while some grammatical doubts were at first raised as to its true interpretation, it was soon understood to be a total prohibition of loans on bottomry and respondentia as usurious; and he adds that it was for the purpose of evading this prohibition, by separating the assumption of the risk from the loan of money, that the contract of insurance was invented. Aluzet states, however, that soon after publication, by reference to the context of the entire document, it was apparent that the true meaning intended was *usurarius non est censendus,* the important word *non* having been omitted by mistake. It was during the period of doubt that insurance was invented.

Insurance historians have commented at some length upon both hypotheses, and by no means agree in their evaluations.

[26] Wright, C., and Fayle, E., *A History of Lloyds* (London: Macmillan & Co., Ltd., 1928), p. 35.

[27] The first English statute relating to the subject of insurance is the famous 43 Eliz., c. 12 of 1601, which has for its purpose the establishment of a tribunal, before which disputes arising out of the insurance contract might be settled. The preamble of the act refers to insurance as a well established business stating "it has bene tyme out of mynde an usage amongste merchants. . . . ."

The first case upon insurance to be found in any book of reports was mentioned by Lord Coke in Dowdale's case decided in 1588. In the course of the action the defendants contended that because the loss arose out of the realm the case could not be tried in London. It was held that: "where as well the contract as the performance of it is wholly made or to be done beyond the sea, it is not triable under our law, but if the promise be made in England it shall be tried." It seems at the time to have been the prevailing idea, however, that disputes arising out of the contract of insurance should be settled by special tribunals rather than by appeal to the courts.

Insurance Becomes Specialized Business. By the beginning of the eighteenth century the business of insurance broker had become a specialized occupation. As the system developed, two marked defects eventually forced themselves to the attention of the commercial community and were instrumental in effecting the next steps in the evolution of the business. While the business of insurance had centered in the hands of specialists, a shortcoming was to be found in the lack of any kind of a financial guarantee of stability on the part of the underwriters.[28] They committed themselves as individuals to a part of the risk insured under the various policies. And a number of these individuals were interested as insurers of each risk. There was no recognized center for carrying on the business, but the brokers who had policies to complete were obliged to go from office to office in order to secure sufficient insurers.

Without any concerted action or preconceived design on the part of any group, underwriters and brokers with common interests began to assemble in the coffeehouses. Lacking other meeting places, the coffeehouses seemed admirably designed to serve their needs. There seems to have been no effort on the part of the coffeehouse managers to limit their patronage to any given class; anyone who desired might be served. But it was natural that those with common interests should be attracted to each other, and specialization in the coffeehouses was the result.[29]

Lloyd's. With insurance underwriting and the coffeehouses the name of Edward Lloyd has become inseparably associated. His coffeehouse, destined to become famous in insurance history, was by no means the earliest of these institutions, nor was it in the beginning the sole resort of the insurance interests. There were other coffeehouses well known and patronized before Lloyd's time, and it may fairly be said that the great institution known as Lloyd's traces its beginning to all of these coffeehouses that served the insurance interests.

It was by going about from place to place that the merchant was enabled to learn of the important events of the day and of the developments of interest to his business. There were very few newspapers, and what there were contained but little of value to the busi-

[28] Wright and Fayle, *op. cit.*, p. 40.

[29] The first coffeehouse of which there is a record opened in 1652. Within a very short time these coffeehouses had become the popular resort of merchants who patronized them for business purposes.

nessman. Mails were slow and postage expensive. News was spread largely by personal contact. Merchants obtained their news by an exchange of information, and for this the coffeehouse served as a place of meeting.

Recognizing the value of supplying this business news, it seems to have been an early custom not only to supply such newspapers as were available but also to post up or circulate letters containing matters of interest to those assembled, a custom not unlike that to be seen among groups gathered in the board room of a stock exchange house today. It seems due to the initiative of Lloyd that his coffeehouse outdistanced its competitors. Lloyd's became recognized as a center for news, and in 1696 Lloyd began the publication of his own paper, *Lloyd's News,* consisting of a single page that appeared three times weekly.[30]

The business of insurance was still carried on by merchants, and the brokers had to go from office to coffeehouse in the course of completing policies. There was, up to the close of the seventeenth century, no centralization of the business; and so far as specialization was concerned, it was at this time limited to the brokers. Coffeehouses were frequented by both insurers, brokers, and the insureds. Their function was at this time primarily to furnish a meeting place for those having common interests and as a source of news. With the trend of insurance interests to Lloyd's the ground was prepared for the sowing of a seed that was to develop into one of the greatest insurance institutions in the world.

Life Insurance in England. In the order of development, marine insurance was first to become permanently established. Life insurance takes the second position. The earliest life insurance policy of which we have any detailed information was made in June of

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[30] The earliest notice of Lloyd's coffeehouse is found in the *London Gazette* of February 18–21, 1688. From this advertisement it is evident that the first Lloyd's was doing business in Tower Street at this date. From numerous advertisements it appears that Lloyd's was from the beginning frequented by merchants and shipmasters. It was not until 1691 that Lloyd left the old location to establish himself in the heart of the business world and to enter into competition with a group of prosperous and flourishing coffeehouses that clustered around the Royal Exchange. It seems that Lloyd's was from the beginning a success and became one of the largest establishments in the vicinity. One of the first advertisements to appear mentioning the house, following the change to Lombard Street, dated 1692, concerned the sale at auction of three ships and their furniture and gave an intimation of the trend in the class of business. At the beginning of the eighteenth century, Lloyd's had not yet become a distinct insurance center but was one of a group of prominent coffeehouses frequented by underwriters.

1583 at The Office of Insurance at the Royal Exchange in London. When this policy was made, however, life insurance was probably not at all uncommon. As a matter of fact, it is known that life insurance was written many years before this time, for the treatise *Le Guidon* to which reference has already been made, while treating mainly of marine insurance, does mention life insurance, stating that while life insurance was practiced in other nations, it was prohibited to insure the lives of persons in France, as *contra bonos mores.* This form of insurance, it is stated, permitted innumerable abuses and frauds, and it was because of these that some of the other nations had been forced to discontinue the practice. It may be that England was one of the countries in which the practice of insuring lives was permitted when *Le Guidon* was published. In any case, there is definite evidence of the existence of the business in the registering of the policy of 1583.[31]

The business made little progress up to the beginning of the eighteenth century. The first life policies issued by the chartered companies in 1720 were for a term of twelve months and were based upon little else than chance and guesswork. The progress of life insurance has been made possible through the development of a scientific system of probabilities. To the mathematicians of the seventeenth century, the business of insurance is indebted for both the formulation of the theory of probabilities, and for the computation and construction of tables of mortality. Without these, life insurance in its modern form would not have been possible.

The Great Fire of London. Friday, September 2, 1666, marks the date of the Great Fire of London. It is also an important landmark in the development of the business of fire insurance. It is hardly correct to say that fire insurance dates from that day, though

[31] The circumstances attending the issuance of this early policy are interesting. On June 18, 1583, the insurance was effected on the life of William Gibbons, for £383, 6*s.* 8*d.*, for 12 months. The policy was signed by 16 underwriters, each individually for his own share, and the premium charged was 8 per cent. The history of this early undertaking hardly reflects credit upon the business dealings of these early underwriters. It so happened that Gibbons died on May 29, 1584, and it would clearly seem that the insurers were liable for the amount of the policy. However, they were not averse to seeking a way out for themselves, and in an effort to save themselves from payment contended that the policy had expired before the date of Gibbons' death. Their argument was based upon the assertion that when they named a period of 12 months as the term of the policy, they intended it to run for 12 months of 28 days each. Reckoning upon this basis, Gibbons had outlived the term of his policy, and the underwriters were thereby not liable for payment under the terms of the contract. It is recorded that the law failed to recognize this quibbling, and the underwriters were obliged to pay.

the stimulus that the fire gave to the introduction and growth of the idea is not to be denied.

So great was the calamity that the anniversary was observed as a fast day for over a hundred years. The fire burned for four days and nights, and its destruction spread over 436 acres of the city's area. Over 85 per cent of the buildings of the city were estimated destroyed, with a property loss estimated at £10,000,000. The blow staggered the city and the kingdom, and it is not surprising that the attention of business interests was then drawn to the field of fire insurance.

Immediately following the fire, it is reported that mutual insurance groups were formed to effect fire insurance.[32] These societies granted insurance, not exceeding £500 on a single risk, and continued in active business for a considerable period.

Fire Insurance Company Organized. In 1667 Dr. Nicholas Barbon opened his office for the insuring of houses and buildings against loss from fire. Dr. Barbon, having failed in the practice of medicine, for which profession he was educated, turned to building and was one of the first of the builders to engage in extensive operations following the fire. He became involved in numerous financial and business schemes, one of them being insurance, and died in 1698 heavily in debt.[33]

Barbon's office merged in 1680 into The Fire Office in which he joined with himself several others in the organization of the first joint-stock proprietary company for fire insurance in London, and probably the first of its kind in the world.[34] The name assumed by the company was "The Fire Office," though it was commonly known as "The Insurance Office at the Backside of the Royal Exchange." The company continued in business for a considerable time; and in 1705 it adopted the name "Phenix Office" from the mark it placed upon buildings that it insured, and carried on operations under this name.

Mutual Association Formed. In 1683 there appeared the pro-

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[32] Walford, *op. cit.*, Vol. III, p. 441.

[33] Our interest in Barbon centers in the fact that he was the first projector of fire insurance in England who succeeded in bringing his scheme to maturity. In the beginning Barbon carried on his business as an individual, and in principle his policies were the same as the marine policies of the time, that is, policies underwritten by individuals.

[34] Relton, F. B., *An Account of the Fire Insurance Companies, Associations, Institutions, Projects, and Schemes, Established and Projected in Great Britain and Ireland during the 17th and 18th Centuries, including the Sun Fire Office, also of Charles Povey* (London: Swan Sonnenshein & Co., 1893), p. 28.

posals for a new society to provide insurance; but this society, unlike Barbon's, was organized on a mutual basis. The proposal was entitled: "A Proposal of a New Way or Method for Securing Houses from any Considerable Loss by Fire, by Way of Subscription and Mutual Contribution." The project was to be known as the "Friendly Society." The following year the original proposals were amended and the mutual insurance association was launched.[35]

In accordance with the proposals of the society issued in 1684, every person becoming a member obligated himself to a tax or assessment limited to 30*s.* for every £100 of insurance. A deposit was required; and provisions set forth the profit for the undertakers, the manner of meeting expenses, and the basis for estimating the necessary contributions.

Just as The Fire Office was the first nonmutual insurance society, so the Friendly Society was the first mutual fire insurance association. The time when the society ceased to do business and the circumstances of its ending are both shrouded in uncertainty.

First of the Permanent Companies. In 1696 the Hand in Hand mutual insurance office was opened. The original title of the organization was "Contributors for Insuring Houses, Chambers, or Rooms from loss by Fire, by Amicable Contribution within the cities of London and Westminster and the liberties thereof and the places thereunto adjoining." This title was afterward shortened to the "Amicable Contributors for Insuring from Loss by Fire," and after a final trimming it was reduced to the brief "Amicable Contributionship." It was not until 1706 or thereabouts that the name "Hand in Hand" attached itself to the company. This name probably grew out of a reference to the emblem or trade-mark of the company which consisted of two clasped hands. The name was not formally adopted by the company until considerably later, probably about 1713–14.[36]

The Sun Insurance Office. The name of Charles Povey is inseparably associated with the development of the modern business of fire insurance. Povey appears on the scene around 1706, and the period between that date and 1710 marks a turning point in the history of fire insurance. It was possibly in 1706 that Povey set in motion his project for writing fire insurance, known as the "Exchange

[35] Walford, *op. cit.*, Vol. III, p. 455.

[36] This Hand in Hand fire office is not to be confused with the American company of the same name, though it served as its model. The American company was not organized until 1752.

House Fire Office located in Hatton Garden," though the business was not in operation until 1707–8.[37]

The first of Povey's fire offices was organized to write business in the city, and the policies were issued by himself. The office was essentially a one-man affair. Povey, however, soon found the business of fire insurance more of an undertaking than was suited to the assets of a single individual. It appears that his early ventures were not entirely profitable, and he then projected a company to take over the business. In 1709 the Company of London Insurers was in process of organization, but it was not until the following year that the new company was ready for business. The company became known from its emblem as the "Sun Fire Office."

The Sun Fire Office or the Company of London Assurers marks the permanent inauguration of fire underwriting by nonmutual companies. This company, organized in 1710, carried on as a partnership until 1726, when a joint stock company was formed with the capital stock divided into shares; and it formally adopted the name "Sun Insurance Office."

The Bubble Period. The second decade of the eighteenth century will always be remembered as an era of stark speculative madness. Strange as it may seem, when the bubbles had burst, and the wreckage had cleared away, the business of insurance was in the final stages of the development that carried it to the threshold of modern times. In fact, if a date can be named that marks the beginning of insurance as practiced today, that date may be fixed at the close of the "Bubble" period, with the granting of Royal Charters to two groups of insurers who became the first of the chartered insurance companies.

Speculation during the period centered around the stock of the South Sea Company organized in 1711 by the Earl of Oxford with an important trading monopoly. When the speculative fever had commenced its work, the soaring market for South Sea stock soon carried it out of reach of thousands who were unable to purchase the coveted security. Rich and poor alike began a scramble for stocks, and swindlers and rogues were not lacking to supply the demand. Other companies sprang up, and opportunities to subscribe for their stock were offered to a gullible public. In the midst of this orgy of speculation and the organization of get-rich-quick undertakings,

[37] Relton, *op. cit.*, pp. 261 ff.

it was not to be expected that the business of insurance would be slighted. Nor was it. During the period of the Bubble mania, there were brought forth about a hundred schemes concerned with insurance, most of them fraudulent or at least impracticable.[88] Strange as it may seem, in this period, noted particularly for its frauds and cheats, there were organized two great insurance companies that have enjoyed an uninterrupted business from that day to this, a span of over two centuries; and they rank today among the leaders in the field.

When the speculative crash came, it was complete. Consternation and rage were everywhere, and the credit of the country was shaken to its very foundations. Parliament was hastily summoned; and upon investigation, frauds were uncovered in which members of the government were involved. The scandal was terrific. In striking the death blow to the bubbles of the period an important insurance development was effected. It marked a turning point with the establishment of the first chartered companies.

On May 31, 1720, the now famous Bubble Act passed the Commons by 123 votes to 22, passed the Lords soon after, and received royal approval under date of June 10. Petitions of two companies for charters were pending, and under the terms of the act the king was authorized to grant the two charters for marine insurance and all other corporations were expressly prohibited to enter upon this business. The right was still reserved for individual underwriters to continue in the business, and this provision exerted a powerful force in shaping the trend of insurance business.

On June 22, 1720, Royal Charters were granted both companies. The first was chartered under the name of the "London Assurance Corporation," and the other was called the "Royal Exchange Assurance Corporation." While it was apparently the intent of the organizers of these companies to write marine business at the begin-

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[88] Besides companies for insuring houses and goods from fire, as well as ships and merchandise at sea, there were companies organized to insure "horses dying natural deaths, stolen, or disabled," and "Masters and Mistresses against losses they shall sustain against servants' thefts, etc." There was insurance for "Insuring and Increasing Children's Fortunes"; for "Insurance from death by drinking Geneva"; for "Assurance from lying"; for "Insurance from Housebreakers"; for "Rum Insurance"; for "Insurance from Highwaymen"; for "Insurance Against Divorce"; and numerous others. The extent to which the absurdity was carried may be estimated from the organization of "A project to insure uniformity amongst Protestant dissenters"; and "Another to insure it amongst the Orthodox" (Martin, *op. cit.*, p. 89).

ning, for which purpose their charters were granted, the following year both merged fire insurance offices that had already been established and were granted charters that permitted the writing of fire and life business.[39]

Beginning of Modern Insurance Business. With the granting of the Royal Charters to the London Assurance Corporation and the Royal Exchange Corporation, we are brought down to the early days of the modern business of insurance. Both of these companies have been continually in business from the date of their incorporation. It is to be remembered that under the terms of the Bubble Act, individual underwriters were still permitted to do business. As a matter of fact, the Bubble Act served as a great stimulus to the business of the individual underwriters, because under its terms all insurance that was not placed with the two chartered companies must be given to them. It was the further association of these individual underwriters that gave rise to the development of Lloyd's, from whose method of doing business, has grown, not only the great organization in England that bears the name, but also the considerable number of similar groups of individual underwriters, whose business is located in different parts of the world, and who are known as Lloyd's Groups. The individual underwriters continued for a considerable period as a dominating factor.

First American Insurance Covered Marine Risks. The first policies issued in this country were marine coverages, issued in part by agents of English companies, and in part by American interests. Records dated as early as 1682 indicate that the vessels plying between England and the colonies carried insurance; and an insurance office was open in Philadelphia whose newspaper advertising appears as early as 1721.[40] Within the next fifty years numerous offices were established, but the business was confined as before primarily to the writing of marine risks.

With the growth of American shipping, the development of marine insurance attained a position of considerable importance. This was particularly the case in New England, where shipbuilding and ocean transportation were leading forms of business activity.

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[39] Street, G. S., *The London Assurance, 1720–1920* (printed for private circulation, London, 1920), p. 21.

[40] Huebner, S., "The Development and Present Status of Marine Insurance in the United States," *Annals of the American Academy of Political and Social Science*, Vol. XXVI, No. 2 (September, 1905), p. 432.

The first major setback came with the War of 1812. American shipping was in a state of demoralization, and the effect upon marine underwriters was evidenced by many failures.[41]

First American Company. With the growth of cities on the Atlantic seaboard and the gradual increase in capital invested in buildings, the problem of fire became of increasing importance. Marine insurance had been written for a considerable period before any effort was made to adopt the principle of insurance to buildings. The earliest efforts to meet the fire problem resulted in the establishment of fire fighting companies. The first of these was organized by Benjamin Franklin in Philadelphia during the winter of 1730.[42]

Franklin had written a great deal on the subject of fire protection in his *Pennsylvania Gazette,* and it is not unnatural that he should have turned his attention to fire insurance. It was not, however, until 1752 that a fire insurance company was actually formed. Following an advertisement inserted in the *Gazette,* a group of citizens organized the Philadelphia Contributionship, patterned after the Amicable Contributionship of London. Both companies marked the buildings they insured with a mark designed as two clasped hands, and because of this both companies became known as the Hand in Hand. Franklin was one of the first to subscribe to the new company and was chosen its first director. John Morton and Robert Morris, signers of the Declaration of Independence, were among the founders and among the first to whom policies were issued. The Philadelphia Contributionship is a mutual organization and is the oldest American company now in business.

First American Stock Company. Because of the lack of accumulated capital in the Colonies, and the scarcity of money in circulation, the formation of stock insurance companies with large sums in paid-in capital was something of a problem. The six largest cities of the time were Boston, New York, Philadelphia, Baltimore, Charleston, and Salem. The largest city had a population less than 50,000, and the combined population was but 131,000.

Underwriting, for the most part, as in the early days in England, was in the hands of individual insurers. In the early Colonial period

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[41] Oviatt, F. C., "Historical Study of Fire Insurance in the United States," *Annals of the American Academy of Political and Social Science,* Vol. XXVI, No. 2 (September, 1905), p. 336.

[42] Gall, H. R., and Jordan, W. C., *One Hundred Years of Fire Insurance* (Hartford: Ætna Insurance Co., 1919), p. 12.

there was little supervision over the underwriters. Their facilities were extremely limited, and in many instances assureds lost through their failure.

When the subscribers to the Insurance Company of North America, with $600,000 in capital, sought a charter from the Pennsylvania Legislature, they met with stubborn opposition on the part of a group of private underwriters. After about a year of labor the subscribers secured their charter and completed the organization of the company December 10, 1792.[43] The company was organized to do a marine business but extended its activities to fire lines during its first year. The Insurance Company of North America is the oldest American joint stock insurance corporation and occupies today an important place in the business of insurance.[44] By the close of the century, 10 mutuals and 4 stock companies were formed; and by 1820 there were 17 stock companies in New York alone, with numerous other companies along the Atlantic seaboard.

Effect of Rate Controversies. One of the earliest difficulties faced by the early underwriters was found in the problem of rate making. The stability of the companies depended upon an income sufficient to meet losses. In the field of fire insurance during periods marked by low burning ratios, companies in their anxiety to secure business frequently cut rates dangerously low. The result, in the event of a conflagration, frequently resulted in failure for many companies and disaster for assureds.

Another contributing cause to the difficulties was the outgrowth of an antagonism on the part of the insurance companies toward the brokers. With the insurance companies cutting rates, either directly or through rebates, they resented the presence of brokers asking for a commission for placing business. In New York, for example, in 1819 eleven companies joined to form the Salamander Society. The organization had for its purpose the establishment of uniform rates for the fire insurance business in New York. In 1826 the society changed its name to the "Association of Fire Insurance Companies." By that time it had thirty-two members. In addition to establishing rates, the

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[43] "History of American Insurance," *Journal of American Insurance,* August, 1924.

[44] For a complete history of the Insurance Company of North America see James, Marquis, *Biography of Business 1792–1942* (Indianapolis: Bobbs-Merrill Company, 1942). Since the Insurance Company of North America parallels in its development the history of property insurance in the United States, this work is a valuable case study of insurance history.

society included among its bylaws a provision that it would pay no commissions for the production of business.

This attitude among fire insurance companies tended to localize the business. Without the service of agents or brokers, companies were forced to rely upon the business that they could place through their home offices or through the agency of salaried solicitors. This development intensified the shock to an insurance company when a severe loss occurred. The New York fire of 1835, with a loss of $20,000,000 in properties, had the effect of wiping out a number of the most active fire insurance companies. Those that were left and doing business carried on with spirits severely chastened. The New York fire of 1835 marks the end of the first period of American property insurance history, with the failure of most of the fire insurance carriers then in business.[45]

First Life Insurance. The Presbyterian Ministers' Fund was granted a charter from the Province of Pennsylvania in 1759. This company was the first permanent life insurance organization to be established in this country. For a considerable period, the company specialized in the writing of annuities and, for a period prior to 1875, was known as "The Presbyterian Annuity Company." After 1875 the company assumed a position of considerable importance in the life insurance field, writing life insurance for clergymen.[46]

Ten years after the organization of the Presbyterian company, there were organized companies along similar lines in New York, New Jersey, and Pennsylvania for the benefit of Episcopal clergymen.

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[45] The many failures following the New York fire were the occasion of much uncertainty and distrust. In the interest of stabilizing the business, the state of Massachusetts in 1837 enacted legislation requiring insurance companies to maintain a certain fund to insure their ability to carry out their contract. This date, therefore, in insurance chronology is said to mark the appearance of reserve legislation as well as the beginning of state supervision of the business. In 1853 New York enacted legislation providing for the so-called unearned premium reserve. Various states have followed with reserve legislation and provision for different degrees of state supervision.

[46] The Insurance Company of North America, whose organization has already been noticed, was the first stock company chartered to write insurance in America. Among its other powers, the company was authorized to write life insurance. By 1799 only a few policies were issued, and within a very few years the company discontinued entirely the life insurance business.

The earliest life insurance policies issued in America were written by individual underwriters and were, for a term, usually covering the period of a voyage or other undertaking regarded as hazardous. Offices supplying this insurance were opened in important cities such as Philadelphia, Boston, and New York; but for a long period there were no insurance companies. The first reported life insurance case in the United States was *Lord* v. *Dall*, 12 Mass. 115, tried in the Massachusetts courts in 1809.

After the Revolution, the Episcopal companies became generally inactive, with the exception of the Pennsylvania company, which enjoyed a long period of usefulness but confined its activities to insuring only Episcopal clergymen. These organizations, however, together with the Presbyterian fund, mark the transition from policies issued by individual underwriters to those issued by incorporated organizations.

The need for the greater security and stability of life underwriters was answered by the organization of life insurance companies with large sums in the form of paid-in capital. A number of the early ventures failed. No small contributing factor to the early difficulties was to be found in the extreme fluctuations in the death rate. Smallpox, diphtheria, and other epidemics swept through the cities bringing death to abnormally large numbers. However, during this period stock life insurance companies made a start, and the companies successfully organized marked the inauguration of life insurance in the United States as a business institution.

The first of the companies, the Pennsylvania Company for the Insurance on Lives, was organized in 1809 and introduced numerous innovations in this country, notably: the requirement of an application, medical examination, and premium charges based upon the age of the applicant. The New York Life Insurance and Trust Company was chartered in 1830 and from the first was active in writing life insurance business. The total volume of business written by these companies was small, and they eventually abandoned the business but continued to do a banking and trust business in the communities where they were chartered.

It is stated that by 1800 there were not more than a hundred policyholders in the country. There was little demand for life insurance because it was little understood, and there was considerable prejudice against the idea. Following the turn of the century a few life companies were organized in America, but the business expanded rapidly abroad. The period was marked by many failures. Bubble companies were organized and frauds were practiced upon the companies by criminals. Control and supervision were lacking, and the business was unstable and widely regarded with suspicion.

Period of Life Expansion: 1840–50. The New England Mutual Life Insurance Company was one of the first of the large life insurance companies to be chartered in this country. The charter was

granted in 1836, but the company did not begin to write insurance until 1844. The Mutual Life Insurance Company of New York had in the meantime been chartered and had written its first business in 1843. The organization of these companies marks the advent of a new era in American life insurance.[47]

In 1858 the Massachusetts Insurance Department was established. This department early turned its attention to the problems of the business of life insurance and, through the agencies of both publicity and appeal for legislative measures, succeeded in initiating some of the most important of the insurance reforms.[48]

At the outbreak of the Civil War, upon one pretext or another, many of the British companies withdrew their operations from this country. Immediately following the war the business of life insurance attracted a great number. Many companies were organized, and with supervision in its infancy, the practices of the companies were not always in line with prudence, sound judgment, or even honesty. The financial panic of 1872–73 rudely awakened insurance supervisors to the necessity of a more strict enforcement of existing law. A rigid enforcement of valuation laws and the striking out of assets of doubtful value from the company statements had the result of forcing a large number of companies from business.

Life Expansion and Competition. Following the purging brought about by the panic of 1873, the surviving companies entered upon a period of active competition. Various forms of policies were offered that led the insurant to extravagant expectations. Policies were issued to run for a period of twenty years on a deferred dividend principle. Agents competing for the business frequently made estimates of results to be obtained in twenty years that insureds interpreted as promises. With falling interest rates and increasing expense items, actual returns fell far short of some of the more

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[47] Zartman, L. W., "History of Life Insurance in the United States," *Yale Readings in Insurance (Personal Insurance)* (New Haven: Yale University Press, 1926), p. 82.

[48] As a result of the work of this department, attention of the insurance world was focused upon some of the steps to be followed if the business was to be conducted on a sound basis financially and upon an equitable basis as between company and insured. The report published in 1865 at the close of the Civil War emphasized the necessity that sound methods of valuation be provided by law. The need of scientific methods of mortality was stressed, as was the place of interest in premium computations. The report further emphasized the importance of nonforfeiture provisions for failure to pay premium and the necessity of a limitation upon the expense item in carrying on the business.

optimistic promises, resulting in a growing public dissatisfaction with the conduct of the business.

During the period more companies entered the field than the need required. Some of the newer companies, the outgrowth of competition, offered extravagant commissions to get business and, ignorant of the basic principles underlying the business of life insurance, were in many instances unable to meet their obligations. Questionable assets appeared in the balance sheets, and it was not infrequently the policy to pay dividends even though they were not earned. Cases of notorious extravagance were brought to light by the newspapers, and a body of displeased policyholders began to grow. Delays in death settlements were not uncommon. As a result, either of ignorance or maladministration, a majority of the large insurance companies organized in the East from 1860–89 were out of business before 1880.[49]

It is to be pointed out, however, that during this period substantial contributions were made to the development of the business. Companies that survived were led by men of integrity and ability. The period, however, in spite of the great constructive work of many outstanding personalities, developed a feeling of antagonism toward life insurance in the mind of the public that was hard to overcome.

Period of Fire Insurance Expansion. The period immediately following 1835 was one of great expansion. It has been referred to as the "Period of Trial and Error." With the rapid development of transportation and communication facilities, an outstanding effect upon the business of insurance was the tendency to eliminate small local companies. The business tended to gravitate into the hands of the more substantial organizations doing business over a wide territory. Competition between the companies continued keen, to the detriment of the business. Not until the period of the Civil War did the seed of actual co-operation between companies begin to germinate.

Following the Civil War, motivated by the prevalence of incendiarism, rate cutting, competition, and hostile legislation, the National Board of Fire Underwriters was organized for the purpose of affording a vehicle for co-operation of the fire insurance companies.

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[49] Dublin, L. I., *A Family of Thirty Million* (New York: Metropolitan Life Insurance Co., 1943), p. 28. This book is a case study of life insurance from the time of the founding of the Metropolitan Life Insurance Company and provides an invaluable fund of material to the student interested in the development of the business of life insurance in the United States.

It was said to be the first national association of business organizations established to promote the public welfare.[50] Among other of its functions at the outset was the establishment of rating bureaus. The country was divided into six departments, with a department committee and office in each. It inaugurated, as well, an intensive program of fire prevention and within the period of the first ten years of its operation had encouraged the establishment of fire departments, water systems, and the improvement of building laws. Fire patrols were introduced and suspected cases of arson investigated with a view of punishing the perpetrators of the crimes.[51]

During this period we find three lasting developments of importance: (1) as a result of expansion, companies began to appoint agents; (2) in large centers they began to pay brokers for business; and (3) it became necessary to provide for the inspection of risks and the adjustment of losses at points distant from the home office. Hence, we have the appearance of the local agent, the broker, and the field man.[52]

Rating Becomes Localized. During the decade following the organization of the National Board of Fire Underwriters two disastrous fires occurred: the Chicago fire of 1871, which was the most destructive fire the country had ever known, and, closely following it, the Boston fire of 1872. In spite of the efforts made by the National Board during a period of a few years, the public clamor for cheap insurance had brought about much rate cutting, which resulted in the failure of many companies when faced with disaster. The in-

[50] National Board of Fire Underwriters, *Pioneers of Progress* (New York, 1941), p. 119.

[51] On April 26, 1876, the tenth annual meeting of the National Board of Fire Underwriters reports the first decade of public service thus: "The Board has been the pioneer in the many wise and salutary laws which have been enacted for the erection of buildings; the prevention of fires; the introduction of that blessing to the people and great medium of safety, a proper water supply; the organization of fire departments; the improvement of those in existence; the introduction of fire patrols into the larger cities; the detection and punishment of incendiarism and arson; the better classification of the various hazards of the country; the improvements introduced into manufactories for their protection, and the greater security which everywhere pervades our land. At the time of the inauguration of the Board, we found the country generally destitute of efficient means of fire protection; not more than twelve or fifteen places had introduced steam into their fire departments. Today no less than 275 cities, towns and villages have paid fire departments, 65 public water works, and 87 an efficient water supply by gravitation—these are but a few of the benefits" (National Board of Fire Underwriters, *op. cit.*, p. 122).

[52] Brearley, H. C., *The History of the National Board of Fire Underwriters* (New York: Frederick A. Stokes, 1916), Appendix I, p. 233, and Appendix II, p. 244.

evitable outcome was a period of confusion extending from 1874 to 1880.

The financial panic of 1873 brought with it a trail of consternation and business failures. Labor troubles developed and troops were called out in an effort to maintain order. Many insurance companies, both in America and abroad, were obliged to discontinue business. A declining American merchant marine had an adverse effect upon the marine business. The depression reached its low point in 1878. During this period the National Board of Fire Underwriters abandoned any effort to control rates. Action to this effect was taken in the April meeting of 1877. At the same time, the board set out on a new line of endeavor inaugurating a program of public relations. It voted to limit its activity to maintaining archives, collecting statistics, dealing with legislation, combating arson, disseminating knowledge of fire causes, and advising local boards.[58] The board continues to function as a fact-finding organization. It serves today by analyzing and seeking to solve the problems of fire prevention and control.

Insurance companies, however, realized that with the breakdown of national rate control some substitute measures must be taken. Unrestricted rate cutting began to make itself apparent with the development of better business conditions that followed 1879. Chicago and Boston were matters of history and forgotten by many. It was apparent, however, to the sober-minded directors of the companies who had weathered the panic and the catastrophes that control of rates was necessary if solvency was to be maintained. Fearful of political intervention if steps were not taken to protect the public the insurance companies set up the plan of regional control. There was some opposition on the part of new companies, but the older companies that had weathered the trying times knew that without adequate rates failures were inevitable.

During this period the duty of rate making was assumed by regional associations. In 1879 the Western Union was organized, then reorganized in 1929 as Western Underwriters. The Southeastern Tariff Association was organized in 1882, and the New England Insurance Exchange was formed in 1883. Other well-known bodies

[58] National Board of Fire Underwriters, *Pioneers of Progress* (New York, 1941), p. 123.

were formed during this period or shortly thereafter. The detail of rate making at this time became a function of these bodies.

The Armstrong Investigation. The growing feeling of antagonism and distrust on the part of the public toward the life insurance business culminated in the New York investigation of 1905. In that year the New York Legislature appointed a joint committee to make a comprehensive inquiry into every phase of the life insurance business. Senator William W. Armstrong was named as chairman, and from him the investigation gets its name. Charles Evans Hughes, later to become Governor of the state of New York and Chief Justice of the United States Supreme Court, headed council retained to conduct the proceedings.

The inquiry searched into all phases of the business. Included within its scope were investigation of allegations of mismanagement, the question of insurance company investments, the relation of company officers to investment transactions, the relation of life insurance companies to subsidiary corporations, as well as a consideration of the problems of government control, the relationship between policyholders and the company, the cost of life insurance, and company expense costs.

The result of the work of this committee was to bring to light abuses where they were found to exist. It was unquestionably true that the life insurance business had not been conducted in many instances in the best interests of the policyholders. On the other hand, it may be truly stated that many of the evils complained of were either exaggerated or were limited to a few companies. It was, nevertheless, true that policyholders were deeply interested in the safety of the insurance business in general and the solvency of the companies writing their own policies. Much important legislation was at that time enacted. Some of the laws passed under the pressure of excitement have since been held to be drastic and unwise, and others have been substituted.[54]

That the investigation marked a turning point in life insurance history goes without saying. There are those who contend that the strong, well-managed, and sound companies that survived the ordeal were subjected, on the part of the public, to much unjust criticism

[54] For a contemporary report of the Armstrong Investigation see Henderson, G. A., *History of the Insurance Investigation* (New York: Legislative Reporting Co., 1906); reprinted in the *Insurance Examiner* for January, 1936.

and to charges that in particular cases were unfounded. While that contention is probably a just one, the fact remains that it was shown that there were abuses growing out of graft, nepotism, participation in political activity, excessive expense items, rebates, and the like. If an occasional injustice followed the investigation, on the whole it was the source of much good.

The Merritt Committee. With the enactment of legislation following the report of the Armstrong Committee, life insurance started out with a clean bill of health. The situation was not quite the same in the field of property insurance. The Armstrong investigation had directed the attention of legislators to the field of insurance, and during the next decade investigations of fire insurance were carried on in at least ten states.

The San Francisco fire of 1906 rocked the fire insurance business to its foundation. Immediately following, there was a general increase in fire rates throughout the country. Because of the fire there was little or no concerted opposition to these rate increases at the time. However, as time went by, the fact that companies were quoting uniform rates began to be a matter of concern. Likewise, the practice of companies settling losses on an indemnity basis, that is, paying for the actual loss sustained rather than paying for the total loss based on the face of the policy, created some opposition. Complaints were registered that companies were making tremendous profits, and so-called "anti-compact laws" were filed with the legislatures designed to make it illegal for companies to combine either to make or to maintain rates. Again valued policy bills were filed designed to make the face of the policy the amount the companies would be obliged to pay in the event of a total loss.

An investigation, made by the Superintendent of Insurance in New York in the spring of 1910, concerning the legislative activities of fire insurance companies brought into prominence the fact that at nearly every session of the legislature anti-compact and valued policy bills were filed and always opposed by the insurance companies. A joint committee of the Senate and Assembly was appointed pursuant to a resolution adopted May 24, 1910. The committee taking its name from the chairman, Hon. Edwin A. Merritt, Jr., is known as the "Merritt Committee." Among other things, the committee was directed to investigate the subject of fire insurance with the hope that the problems surrounding the contested legislation could be

solved and grounds could be found either for passing or rejecting the measures.

The public hearings on fire insurance began on November 22, 1910, and ended on January 6, 1911. The investigation was comprehensive and far reaching, and witnesses from every interested source were heard. Leaders in specialty fields throughout the country were examined, and conditions in the state of New York were compared with those existing in a number of other important states. The committee published its report in 1911.[55] It went on record as opposing anti-compact laws and as well the arbitrary regulation of fire insurance by the states. It urged, however, that rating bureaus established by the companies be recognized and regulated by the states. This report is far reaching in its effect because it definitely reversed the established trend which heretofore regarded fire insurance companies that combined to make or maintain rates as forming trusts and, hence, as antisocial. The investigation tended to clarify misunderstandings based upon misapprehensions regarding unduly large profits and clarified the atmosphere in the matter of premium charges and rating organizations by pointing out that unrestricted competition frequently led to inability to pay losses and, hence, company failures. Legislation following the report of the Merritt Committee did much the same for the fire insurance business that legislation following the Armstrong report did for the life insurance business. Both tended to renew public confidence and enhance the prestige of the insurance business.

Development of Multiple Line Companies. Previous to 1910 the business of insurance was carried on chiefly by companies devoting their efforts, for the most part, to a single line. But about that time, a new movement began to be recognized; large groups were organized writing a wide variety of coverages.

In 1910 one of the leading companies in the surety business entered the general casualty field. Fire companies organized indemnity companies. The movement spread with other casualty companies beginning to reach into new fields and more fire companies, following the example already set, organizing casualty subsidiaries.

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[55] *Report of the Joint Committee of the Senate and Assembly of the State of New York Appointed to Investigate Corrupt Practices in Connection with Legislation, and the Affairs of Insurance Companies, Other than Those Doing Life Insurance Business,* Assembly No. 30, transmitted to the Legislature February 1, 1911 (Albany, N.Y.: J. B. Lyon Co., 1911).

The result of this trend was the development of large, powerful groups, in whose hands is now concentrated a large volume of the fire, casualty, and surety business of the country.

With the development of multiple line facilities, insurance companies have been able to write broader lines of coverage in a single document. The more recent tendency has been quite definitely in the direction of all risks policies. Largely because of the accident of historical development, insurance companies are limited because of legal restrictions in the forms and types of policies they may issue. The demand for all risks coverage and broad and comprehensive policies has instituted a trend in the insurance field in the direction of statutory enactments designed to break down the barriers that limit the fields in which property insurance companies may operate. In the meantime, the companies within the limits of their legal capacities, either as individual companies or as groups, are broadening the coverages they are offering with a view to answering the public demand for complete insurance coverages and are even anticipating that demand.

It has been generally conceded that multiple line underwriting and the broadening of corporate powers of insurance companies to permit them to write the business represents a logical step. From a practical standpoint, there have been inhibiting forces. It has been felt by some that steps in this direction should be taken cautiously in order not to effect serious dislocations in the business. Those who do not agree with the idea of multiple line underwriting contend that there is no real demand for such policies on the part of the public. They argue, on the other hand, that multiple line underwriting will tend to concentrate the insurance business in the hands of large groups to the detriment of the smaller insurance companies. Even the possible elimination of the smaller companies has been predicted. It is argued that such benefits as may come to the public through multiple line underwriting are offset by the sizable tasks of readjusting state laws, regulatory systems, and the various effects that small companies may feel. It will be recognized that these objections originate primarily with the companies. If the trend to multiple line business proves, in the long run, to be in the public interest it will be hard to stay progress.[56]

[56] An example is the new Massachusetts Multiple Line Law (c. 384), which became effective in Massachusetts January 1, 1946. Similar statutes have been enacted in New Jersey, North Carolina, and Pennsylvania.

The First World War. With the attack on Serbia by Austria on July 28, 1914, a chain of repercussions were set in motion that brought insurance face to face with situations new in the history of the business. Security markets were demoralized, and the final crash came when on July 31 the New York Stock Exchange suspended. While these were uneasy times for all financial institutions holding vast amounts of securities, they were particularly dark for insurance companies who were dependent upon the ability to liquidate these securities in the event of great need.

More directly, however, the repercussions of war were felt in the business of marine insurance. When, on August 1, Germany declared war on Russia, followed shortly by the invasion of Luxemburg and a declaration of war on France, with the later invasion of Belgium by Germany and the entrance of England into the war, the American marine market was faced with an impossible situation. Marine insurance for a time was impossible to secure; or when rates were quoted they were so prohibitive as to virtually amount to a closing of the market. American insurers were deprived of the facilities of European reinsurance. England as a source of direct insurance was for the time being unavailable, as were the other European insurance markets. The resources of the American market were unequal to the enormous demands, and for a time the situation was little short of chaotic.

In August a committee of important business interests appealed to the government, and upon recommendation of Secretary of the Treasury McAdoo a bill creating the Bureau of War Risk Insurance was placed before Congress. This bill became a law on September 2; and insurance was offered on American vessels, their freight, cargo, and passenger money whenever this coverage was unobtainable elsewhere at reasonable rates.

In the meantime, American insurance interests had stabilized their business and were able to quote rates on the enormously stepped-up market for the ordinary marine perils, and wrote as well a substantial amount of the war risk insurance. It became necessary for insurance companies to expand their capital resources. This new capital was readily forthcoming. There was a boom in shipping, and this in turn was followed by a boom in insurance. Fire companies that had hitherto not participated in marine underwriting entered the field, and new companies made their appearance. Enor-

mous expansion in American facilities enabled the companies to write lines with ease that prior to the war could have been placed only with great difficulty.

In the other property insurance fields the business reflected the industrial growth evidenced by a wartime boom. Insurable property values increased tremendously. At the same time, hazards were increased as a result of wartime operations. There was always the problem of inexperienced help, hastily constructed buildings, the handling of explosives, carelessly constructed buildings, and such other factors that evidence themselves only in a period of emergency or wartime activity. The services of engineers, underwriters, inspectors, and other experts in the employ of the insurance companies were made available to industry and to the government to the end that wartime hazards be minimized and production accelerated. While there were severe losses directly attributable to wartime activity, such as the munitions disaster of Black Tom, New Jersey, attributed to German saboteurs, the companies were able to meet all losses and provide adequate insurance for industry during this period.

Perhaps the outstanding contribution in the field of insurance during the first World War was the establishment of the principle that certain hazards were beyond the capacity of private industry and should be handled by the government. The government's participation in marine insurance has been noticed. Life insurance likewise became faced with a war risk problem. Obviously, life insurance companies had no experience upon which to predicate insurance policies for soldiers engaged in combat. Under an act of Congress approved October 6, 1917, members of the military forces of the United States, in addition to other privileges, were given the right to take out life insurance with the government. Total war risk insurance in force was at one time in excess of $40,000,000,000; but, with the termination of hostilities, much of the insurance carried through the period of the emergency was allowed to lapse. The life insurance industry made available to the government its actuarial facilities and the services of its experts in the field. It did everything possible to encourage military personnel to avail themselves of this life insurance coverage and instituted a program directed to encourage the retention of the insurance after the serviceman had terminated his wartime activities.

The Depression of 1929. The business collapse of 1929 severely

tested the business of insurance. The crash carried in its train a severe recession of business activity with a long line of business failures, the closing of an unprecedented number of banks, and a market panic that had, among other effects, the wiping-out of fortunes overnight.

The collapse in security prices in 1929 had the effect of depleting the assets of all insurance companies. Accompanying a continued shrinkage in security prices was a sharp increase in unemployment and a falling-off in business. At one time it appeared that the solvency of a large number of fire and marine companies was in danger. By 1932 security prices had touched bottom, but a wave of bank failures threatened to engulf the country. Efforts of the Reconstruction Finance Corporation to stem the tide proved to be only of temporary effect. Hoarding continued to weaken the banking structure, and renewed bank failures stimulated runs.

The impact of the disaster was felt upon all branches of business. It would have been impossible for the entire economy of the country to sustain such a shock without important repercussions upon insurance. In the field of property insurance, declining business and shrinkage of values carried with it precipitous reductions in premium volume. At the same time, losses mounted sharply. That these companies weathered the difficulties and retained public confidence is to their everlasting credit.

In the field of life insurance the problems might have been wellnigh insurmountable. Certainly, the financial crisis was the greatest the business had ever faced in its entire history. In the early days of the depression, living policyholders were able to convert vast sums in policy values into cash through policy loans, surrender values, or withdrawal of deposited funds. Maturing contracts were paid promptly without question. With the breakdown of the banking structure early in 1933 the financial machinery of the country ceased to operate. Facilities for transferring funds either to or from home offices were lacking. The same fear that prompted withdrawal of funds from banks for hoarding spread to the holders of life insurance policies with the result that tremendous demands were made upon life insurance companies for funds to be used for no other purpose than for hoarding. No company, however strong, could in the long run avoid the effects of a situation such as this.

With the termination of banking facilities which made the trans-

fer of sizable amounts of money difficult, if not impossible, the insurance departments of the various states recognized an emergency that required prompt and immediate action. The life insurance companies were, in fact, being asked to take over the banking functions of the country. This was a task they were neither organized for nor equipped to handle. They were in a position to meet obligations contemplated in the contracts, but it was realized that any wholesale demand on a nation-wide basis to convert insurance equities into cash might immediately precipitate a crisis.

The Superintendent of Insurance of New York called a meeting of life insurance company presidents to appraise the situation. He then discussed the entire situation with the Governor of New York and with leading members of the legislature. As a result, emergency legislation was passed with restrictive regulations on loans. Other states followed with like legislation. Following a meeting of the executive committee of the National Convention of Insurance Commissioners, held in Chicago in the spring of 1933, it was recommended to the various state authorities where an extension of the bank moratoria was contemplated that life insurance receive the same consideration as banking in any legislation that might be adopted.

The life insurance companies themselves went far beyond the legal requirements in extending leniency to policyholders. In some instances loans were advanced on equities where the policy actually called for no cash value. On the other hand, other legal enactments, such as the extending of grace periods, the enactment of moratoria on mortgage interest, and the like, resulted not only in inconvenience to the companies but in actual losses in many instances. Nevertheless, in every state, regardless of emergency regulations, death claims, disability benefits, and matured endowments were promptly paid when due. The prestige of life insurance in this trying period continued to grow.

Impact of Social Security. The Social Security Act as passed by Congress in 1935 was the cause of some uneasiness on the part of many associated with the business of insurance. There were intimations that the Social Security program would serve as an entering wedge to bring the government generally into the business of insurance and that ultimately the program would absorb all, or at least a considerable portion, of the field covered by private insurance enterprise. There was at the outset considerable misunderstanding

evidenced on the part of many. Today the program is far better understood; yet it is not unusual to see comments that evidence a complete misconception of its purpose.

The business of commercial insurance has today co-ordinated its program admirably with the program of Social Security. It has recognized that there is a place for social insurance in the field and that it is possible to establish an acceptable line of demarcation between the fields of commercial insurance and social insurance. Private insurance underwriters feel that commercial insurance should embrace the protecting of individuals or business enterprises on an individual contract basis wherever insurance needs or requirements are in excess of a minimum deemed essential from a purely social standpoint.

The social insurance program, as it has developed, aimed to embrace the entire population, or large groups thereof, and provides a minimum of protection determined necessary for a sound social structure. The field of commercial insurance and the protection of the property accumulations of the individual or his special needs in the fields of personal insurance are left to private insurance. This division of the insurance field leaves to commercial insurers the sources of revenue from which the volume of income has always been obtained. It is true that there are some who are fearful that any extension of the Social Security program will encroach upon fields where private enterprise is now getting business. More mature judgment, however, indicates that if, from the standpoint of the general social good, it is felt that the need for minimum protection for all the members of a group cannot be satisfactorily met by voluntary commitment on the part of individuals in the group concerned, then social insurance must be considered as acceptable.

In some fields, notably in the fields of group life insurance and the allied field of annuities for pensions, the Social Security program has contributed tremendously to the development of the business. The Social Security plan focused the attention of the entire nation on the subject of retirement incomes. The insurance industry was quick to grasp the opportunity of supplementing the Social Security program with other forms of life insurance, to the end that the two sources of protection combined are more in line with the needs of the individual than if he relied for his protection upon Social Security alone.

It may be stated that the Social Security program has now been generally accepted by the insurance business as an established and essential feature of our economy. Proposals for its extension raise the question as to the limitations to which the program may logically be extended without going beyond its function of providing a minimum protection, for large groups, essential for a sound social structure. The program itself has passed out of the realm of debate. Such doubts as now exist are the outgrowth of proposed extensions.

Temporary National Economic Committee. Life insurance along with other big business became the object of criticism and suspicion during the period of the depression. The Temporary National Economic Committee, now widely known as the "T.N.E.C.," in the course of its investigation of the concentration of economic power, in response to a message from President Roosevelt, included within the scope of its studies the investment activities of the business of life insurance. The life insurance study was assigned to the Securities and Exchange Commission. A council and special staff were appointed for the work and included in its investigation, not only insurance investments, but also the general management of the companies.[57]

The committee commenced hearings in 1938 and they were carried on into 1940. Designed as a fact finding study, the investigation was limited to the business practices of the twenty-six leading life insurance companies in the field.[58] The attitude toward life insurance in many instances was extremely critical, and some apprehension was expressed on the part of life insurance interests that much of the evidence that went into the record was conducive to conclusions

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[57] In the message of President Roosevelt to the Congress on April 29, 1938, the President stated: "The tremendous investment funds controlled by our great insurance companies have a certain kinship to investment trusts, in that these companies invest as trustees the savings of millions of our people. The Securities and Exchange Commission should be authorized to make an investigation of the facts relating to these investments with particular relation to their use as an instrument of economic power" (*T.N.E.C. Hearings,* Part 28, p. 14695).

[58] In his introductory remarks at the opening of the hearing, February 12, 1940, Mr. Leon Henderson of the Securities and Exchange Commission stated: "A word of caution about the completeness of the present insurance inquiry. The S.E.C. makes no pretense that every phase of life insurance has been canvassed. There are 306 life-insurance companies with assets of $28,000,000,000. We have never had more than 10 men in the field, with a limited home-office staff. The present investment study covers the 26 leading companies, but no study could be called complete which omits review of the investment experience of 280 smaller companies, having several million policyholders and around $4,000,000,000 of assets" (*T.N.E.C. Hearings,* Part 28, p. 14696).

which were unsound. Criticisms were levelled at the size of the business. The possibility of interlocking directorates involving life insurance offices in other business operations, where there might be a possibility of a conflict of interests, was scrutinized. Studies were made of accounting practices with a view to determining whether or not policyholders were being overcharged and whether or not they were being advised of the business operations of the company. The investigations were extensive and far reaching, but in the end the life insurance companies found the conclusions to be most complimentary. Many of the recommendations had to do with the strengthening of the control of the various state insurance departments. The committee was careful not to criticize state regulation but pointed out that in many instances control of huge business organizations that cross state lines is beyond the capacity of state departments.

The committee added that without mandatory federal regulation the federal government could utilize its powers to strengthen state regulation and make it more effective. Suggestions in this direction were federal statutes preventing the use of mails or radio to sell insurance in states where a company had not been lawfully admitted to do business. Amendments to the National Bankruptcy Act were suggested that would be helpful to state insurance commissioners, and a federal statute was suggested that would make illegal improper gains derived by officers and directors of companies through the use of their position.

The investigation, on the whole, reacted favorably to the life insurance companies.[59] Rather than shaking public confidence, the investigation strengthened it. It stimulated the companies to renewed activity in the field of public relations and gave new impetus to the studies already under way, looking to the betterment and improvement of the business in its entirety. Like other investigations preceding it, the net result to the business was regarded as good.

World War II. In World War II, as in the case of World War I, the insurance industry made available to the government its experts to assist in providing insurance coverages and, in addition, made available its engineering services to safeguard war production activ-

[59] The hearings were limited to life insurance, Mr. Henderson stated. "Sheer lack of funds has forced the Commission to reject all suggestions of inquiry into fire and casualty and other forms of insurance" (*T.N.E.C. Hearings*, Part 28, p. 14696). In its report the committee recommended a study of other forms of insurance.

ities. In the underwriting field, however, the industry was called upon to face extraordinary tensions.

Prior to the actual outbreak of war between the United States and the Axis, contracts were being let in this country to private industry for the manufacture of billions of dollars worth of military supplies. Many of these projects were extremely hazardous in nature, and the insurance coverages were beyond anything that private property insurers had heretofore been called upon to underwrite. In some instances the risk was entirely unknown to previous experience, and the catastrophe hazard very great.[60] In instances it involved assuming risks in parts of the world where language, customs, and methods of doing business presented problems unheard of to companies writing insurance business in the United States. Insurance coverages provided for the building of airfields, railroads, highways, and military installations of every conceivable nature. In addition, insurance was continued effective upon thousands of plants that had converted from peacetime activities to the production of every type of military supplies.[61]

In the field of life insurance the industry contributed its experts to assist in setting up an insurance program to cover the lives of persons in military service. The industry was active in co-operating with the government program to curtail inflation and actively co-operated in bond selling programs. The life insurance industry was not called upon to assume war risks; for, as in the case of World War I, life insurance on military personnel was handled by the government. But it did carry a substantial part of the war burden through the heavy purchase of war bonds. At the end of 1945 these holdings amounted to approximately $20,800,000,000. The life insurance business itself felt the pressure of low interest rates current in the period, and perhaps the most marked resulting development was the

[60] For example, with the release of the news concerning the plants constructed for manufacturing the atomic bomb, it became known that the plant at Richmond Village, Washington, was covered for liability insurance by The Travelers. The company carried the risk, it was stated, without any knowledge of what was to be manufactured. On a second plant, at Oak Ridge, Tennessee, compensation and public liability insurance were carried by the United States Fidelity and Guarantee Company of Baltimore.

The atomic bomb plants were one of two hundred unusual war risks carried by private insurance enterprise, which included, among others, coverage for the contractors on the Alcan and Central American highways and the Big Inch and the Little Inch pipe lines.

[61] The Travelers Insurance Company, *The Travelers Follows the Flag* (Hartford, Conn., n.d.), p. 5.

search for investment outlets. A new trend made its appearance with life insurance companies holding real estate equities as investments instead of bonds, and some companies commenced to show an interest in selected preferred stocks where the yield compared favorably with medium grade bonds.

The repercussions of the war upon the business of insurance made themselves most evident, however, in the field of marine insurance. To carry supplies to the armed forces and to maintain our home front, it was necessary that our ships sail the seven seas. Hand in hand with the business of shipping is to be found the business of marine insurance.

With foresight born of experience gained in the first World War, underwriters prepared themselves to handle the war risk business. Understanding the necessity of concerted action and the maintenance of an orderly market capable of functioning in the most severe crisis that could be anticipated, American marine underwriters formed the American Cargo War Risk Reinsurance Exchange to handle cargo risks.[62] The membership of the exchange comprised about 140 marine companies and embraced virtually every marine company in the American market. It had assets in excess of one billion dollars, and actually commenced functioning in June, 1939. By means of this venture it was possible to quote standard rates throughout the market as well as to supply adequate facilities for American needs. This was in contrast to the condition following the outbreak of the first World War.

From the period when this operation first commenced until the declaration of war by the United States upon the Axis the exchange operated profitably. Serious losses developed but, in the long run, the results were generally favorable. With the impact of actual war, however, it became at once apparent that the temporary period of prosperity was at an end. Toward the middle of January, 1942, the sinking of the Norwegian tanker "Norlina" set up a train of losses that were far beyond the calculations of the underwriters. This sinking is regarded as the commencement of a submarine campaign that reached a state of fury beyond any expectation used as a basis for rate making. Marine underwriters were not slow, however, in attempting to adjust rates to new conditions. The second quarter of 1942 was, nevertheless, a dark hour, but steps were well under way to affect an

[62] Pursuant to Section 29 of the Merchant Marine Act of June 5, 1920.

adjustment of rates to make them commensurate with the risk. This called for a drastic mark-up.

Commercial insurance, in the long run, can operate only with adequate rates. An increase in insurance rates in an amount necessary to meet the situation meant a sharp increase in the price of imports. This was contrary to the government anti-inflation program. The maintenance of the price structure was deemed of paramount importance by the government and to this end it undertook to provide insurance on imports and on exports to the United States possessions on a basis that would maintain the existing price structure. The War Shipping Administration was set up to handle the war risk business, and operations commenced in May, 1942. The immediate effect of the establishment of the War Shipping Administration was the transference to the government of virtually all war risk insurance on imports. Commencing August 1, 1942, virtually every company writing marine insurance in the country became underwriting agents for the government. These underwriters agreed to act as agents for the government and by wholeheartedly entering into the spirit of the relationship thus created, devoted a major part of their time to this line of activity.

Prior to the outbreak of war, property insurance companies wrote a policy known as "bombardment insurance." It became at once apparent to insurers following the declaration of war that land war risks might produce losses beyond the ability of private insurers to pay. It was pointed out that the probable catastrophe loss might be so great as to threaten adequacy of protection. It was felt that the government was the only agency able to assume the obligations of indemnifying the citizens against loss or damage caused by foreign enemies. The outcome of this situation was the development of the War Insurance Corporation created by the Reconstruction Finance Corporation and designed to provide insurance for property owners against war "damages to, or destruction of buildings, structures, and personal property including goods, growing crops, and orchards." Here, as in the case of marine insurance, private insurance underwriters operated as agents for the government corporation in placing the business on a purely nominal basis. It is to be noted that in the war risk coverages private insurance and the government set a precedent that will be of long lasting significance in co-operative effort. The fields of government and private industry did not over-

lap and when the need for government participation ended the government withdrew from the field.

Looking Forward. In the period between the first and the second World War the insurance business enjoyed a period of great expansion. A trend less readily recognized has been the growing consciousness on the part of private insurers that any uninsured loss has social repercussions extending beyond the immediate effects on the parties concerned. For example, if a business suffers a fire loss without adequate insurance and, as a result, is obliged to close its doors, it may mean unemployment for the members of the staff and financial loss to creditors. Examples could be cited indefinitely in the field of property insurance where uninsured property losses would carry social implications. So in the field of personal insurance death, accident, or illness without adequate insurance brings great misfortune to the individuals themselves and may even bring a burden to society. In this, private insurance recognizes a responsibility.

The insurance business in approaching this change in philosophy is adapting itself to carry as much of the insurance burden as private enterprise and capital are equipped to handle. By the same token, the business of insurance recognizes that there is a field in which it is not equipped to participate. This is the field handled by the government, and the forms of insurance concerned are those to which the term "social insurance" is usually applied.

In looking forward, the private insurance industry is deeply concerned with the future direction of its business. Its primary concern is to establish a line of demarcation between private, business, and social insurance. Private insurance underwriters have felt that the field of commercial insurance should embrace the protecting of individuals or business enterprises on an individual contract basis, whenever insurance needs or requirements are in excess of the minimum deemed essential from a purely social standpoint. This changing attitude has involved an expansion of insurance facilities and a breaking away from long-established customs. Generally speaking, the business has responded admirably. As has been said elsewhere:

> Management, as far as its attitude toward the future is concerned, seems to fall into two groups. For the most part, management recognizes that insurance must be flexible and adaptable and, instead of opposing trends that seem to be unquestionably established, looks rather to the new situations. In contrast, there is a small but articulate minority that seems bent, whenever important changes from

the *status quo* are suggested, upon exhausting itself with an opposition that seems destined to be futile.[63]

By far and large the constructive attitude of the insurance business was some years ago aptly expressed when it was stated that the mores of the insurance business are that "the first duty of each organization is to the policyholder rather than to the stockholder; to the body politic rather than to the body corporate; to those who are served rather than to those who do the serving. . . . ."[64] Keen observers of the progress of the business indicate that successful expansion has been accompanied by this progressive attitude. With continuing adherence to this philosophy and a flexibility to adapt the business to expanding needs, the continued need for commercial insurance presents no horizon. The business that prides itself upon surviving wars, panics, and catastrophes seems to face no particularly unfavorable developments. The situation is quite the reverse.

FOR REVIEW

1. Define "insurance," and compare the contract with the contract of bottomry.
2. In Exodus 22:6, it is stated that if a fire breaks out and catches thorns so that the stacks of corn or the standing corn in the field be consumed, he that kindled the fire shall surely make restitution. This is sometimes cited as evidence of early fire insurance. What is your opinion?
3. Discuss the place of bottomry in the business life of ancient Rome.
4. What, if any, means for effecting insurance was known during the Middle Ages?
5. Compare the Roman *collegia tenuorum* with the modern fraternal insurance society.
6. At what date do we begin to find evidence that a contract of insurance, aside from bottomry, had been developed?
7. When the early English policies were first written, who were the insurers?
8. Discuss the most important shortcomings in the business of insurance as carried in England at the beginning of the eighteenth century.
9. What was the significance of Lloyd's Coffeehouse in the development of insurance in England?
10. Which form of insurance was the most common in the early eighteenth century: Marine? Life? Fire? Give the order of their appearance as commercial enterprises.
11. Why is September 2, 1666, regarded as a significant date in the history of fire insurance?

[63] Magee, John H., "The Future of the Commercial Insurance Business," *Harvard Business Review*, Vol. XXI, No. 3 (Spring number, 1943), p. 321.

[64] Benjamin Rush of the Insurance Company of North America, quoted by James, Marquis, *Biography of a Business* (Indianapolis: Bobbs-Merrill Co., 1942), p. 234.

12. Discuss the insurance element as it developed in the ancient contract of bottomry.
13. In ancient Greece, bottomry loans were frequently arranged so that the money was advanced by a group rather than by an individual. Compare this with Lloyd's underwriting of today.
14. Gibbon in his *Decline and Fall of the Roman Empire* refers to bottomry loans as "nautical insurance." He points out that Justinian, in 533, fixed the rate of interest to be charged on ordinary loans at 6 per cent, but in the case of *Fenus Nauticum* 12 per cent was permitted. In your opinion does the difference in interest rate indicate a recognition on the part of the Roman lawmaker of the insurance element in the bottomry agreement?
15. Discuss the guilds as insurers.
16. There is nothing left us by contemporary writers to show us that there was any business transaction ordinarily carried on among the ancients that could be construed to be fire insurance. Juvenal, in his satires (iii. 215) points out, however, that there was a well-established custom among the wealthy of ancient Rome, whereby voluntary contributions were made by friends and neighbors to those who suffered a loss from fire. Discuss this from the point of view of insurance.

CHAPTER II

THE FIELD OF INSURANCE

THE Function of Insurance. The function of insurance is to provide certainty. To effect this end insurance seeks to reduce the uncertain consequences of a known peril, so that the cost of losses as they affect individuals will be certain, or at least relatively certain. "People want decent homes to live in; they want to locate them where they can engage in productive work, and they want some safeguard against misfortune which cannot be wholly eliminated in this man-made world of ours."[1] In the process of providing safeguards against these hazards the insurance idea has developed.

Insurance Defined. As a process for effecting certainty when some peril threatens, insurance may be defined broadly as the guarantee by one to another against accidental loss. There are numerous other definitions, each modified to a greater or less degree by the end the particular form attempts to achieve. For example, insurance has been defined as a contract whereby, for a consideration, the insurer binds himself to compensate the insured if the latter shall suffer loss. Legal status has been given the definition:

> Insurance is a contract by which the one party, in consideration of a price paid to him adequate to the risk, becomes security to the other that he shall not suffer loss, damage, or prejudice by the happening of the perils specified to certain things which may be exposed to them.[2]

As a business institution, insurance has been defined as a plan by which large numbers of people associate themselves and transfer, to the shoulders of all, risks that attach to individuals. It has as its end the reparation of a serious injury to individuals at a moderate cost, by arranging a means whereby, if a certain loss fall upon one, it shall be made good at the expense of many. It amounts to the shifting of the burden of risk from the shoulders of the individual to those of a group prepared and willing to assume it. An adequate definition

[1] Message of the President to Congress, June 8, 1934, *Economic Security Act, Hearings Before Committee on Ways and Means, House of Representatives, Seventy-fourth Congress, First Session on H.R. 4120* (Washington, D.C.: United States Government Printing Office, 1935), p. 17.

[2] *Lucena* v. *Crauford*, 2 B. & P. N. R. 269 (H.L. 1806).

giving recognition both to the end of insurance and to the means for effecting it has been admirably stated thus:

> We should define insurance, then, as that social device for making accumulations to meet uncertain losses of capital which is carried out through the transfer of the risks of many individuals to one person or to a group of persons. Wherever there is accumulation for uncertain losses, or wherever there is a transfer of risk, there is one element of insurance; only where these are joined with the combination of risks in a group is the insurance complete.[3]

In the ordinary course of business the foregoing definition applies; to effect insurance, persons who are exposed to loss from some particular peril agree to contribute to indemnify whichever member of the group shall, because of the peril, suffer loss. It is the more usual practice to contribute to a common fund and, out of this fund, to make payments to those who have suffered loss. The payment to the fund represents the cost to the individual of his losses because of the specified peril. Thus, a person owns a house valued at $5,000, and it is possible that the house may be totally destroyed by fire. He is faced with the uncertainty of a $5,000 loss. He may, however, for the payment of a definite sum agreed upon by an insurer, eliminate the possibility of a $5,000 loss. He obtains certainty by exchanging an uncertain large loss for a certain small loss.

In the strictest interpretation of the term, aside from its customary use in the field of business, contributions to a fund by beneficiaries are not essential. As has been said: "The collective bearing of risks is insurance. It is insurance, whether the individual contributes specific premiums to meet each specific risk, or whether he receives free insurance out of the general resources of the community or of an industry. It is insurance whether the contributions are voluntary or compulsory."[4] It is conceivable that groups rely entirely upon assessments after losses to indemnify the sufferers and in such instances accumulate no funds in advance. In the case of insurance enterprises in which the government functions as the carrier, a fund may be accumulated, or the beneficiaries may depend for their insurance payments upon the taxing power. As a business, insurance evidences its strength on the basis of a demonstrated ability to pay,

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[3] Willett, A. H., *The Economic Theory of Risk and Insurance,* Columbia University Studies in History, Economics and Public Law, Vol. XIV (New York: Columbia University Press, 1901), p. 388.

[4] Beveridge, Sir William, *Insurance for All and Everything, the New Way,* Series VII (London, 1924), pp. 6–7.

and hence the established practice of accumulating a fund out of which losses are to be paid.

The contract is termed the "policy." Park states: "Policy is the name given to the instrument by which the contract of indemnity is effected between the insurer and the insured; and it is not like most contracts signed by both parties, but only by the insurer, who, on that account, it is supposed, is denominated the Underwriter."[5] He then adds that, notwithstanding this fact, there are certain conditions to be fulfilled by the person not subscribing as the underwriter; otherwise, the policy will be void.

The monetary consideration for the policy is termed the "premium." The limit of liability expressed in the contract, or, in other words, the amount of insurance, is termed the "face of the policy." The company, group, or individual assuming the burden of the risk in the capacity of underwriter is termed the "insurer" or "carrier."

A Basic Industry. Insurance in the United States today is regarded as a basic industry, ranking in importance with agriculture, commerce, banking, manufacturing, transportation, and communication. In its several branches, the business of insurance employs a vast army of workers whose co-ordinated efforts provide the factor of protection now regarded as essential in our scheme of industrial organization.

While there is scarcely anyone who does not at some point or other make contact with the business of insurance, there are few indeed who, without some reflection and investigation, have an adequate idea of the great size and importance of the business. There is no industry which is not dependent upon it and no individual who does not owe to it substantial credit for daily comforts and conveniences.

The institution of insurance embraces a wide field. This text is concerned primarily with that division of the field that comprises the vast commercial organization known as the insurance business. To understand the position of commercial insurance in relation to other forms of insurance undertakings, it is necessary to review the entire field briefly.

The Division of the Field. The institution of insurance as a part

[5] Park, J. A., *A system of the Law of Marine Insurance, with three chapters on bottomry, on insurance on lives, and on insurance against fire* (3d ed.; Dublin: James Moore, 1742), p. 1.

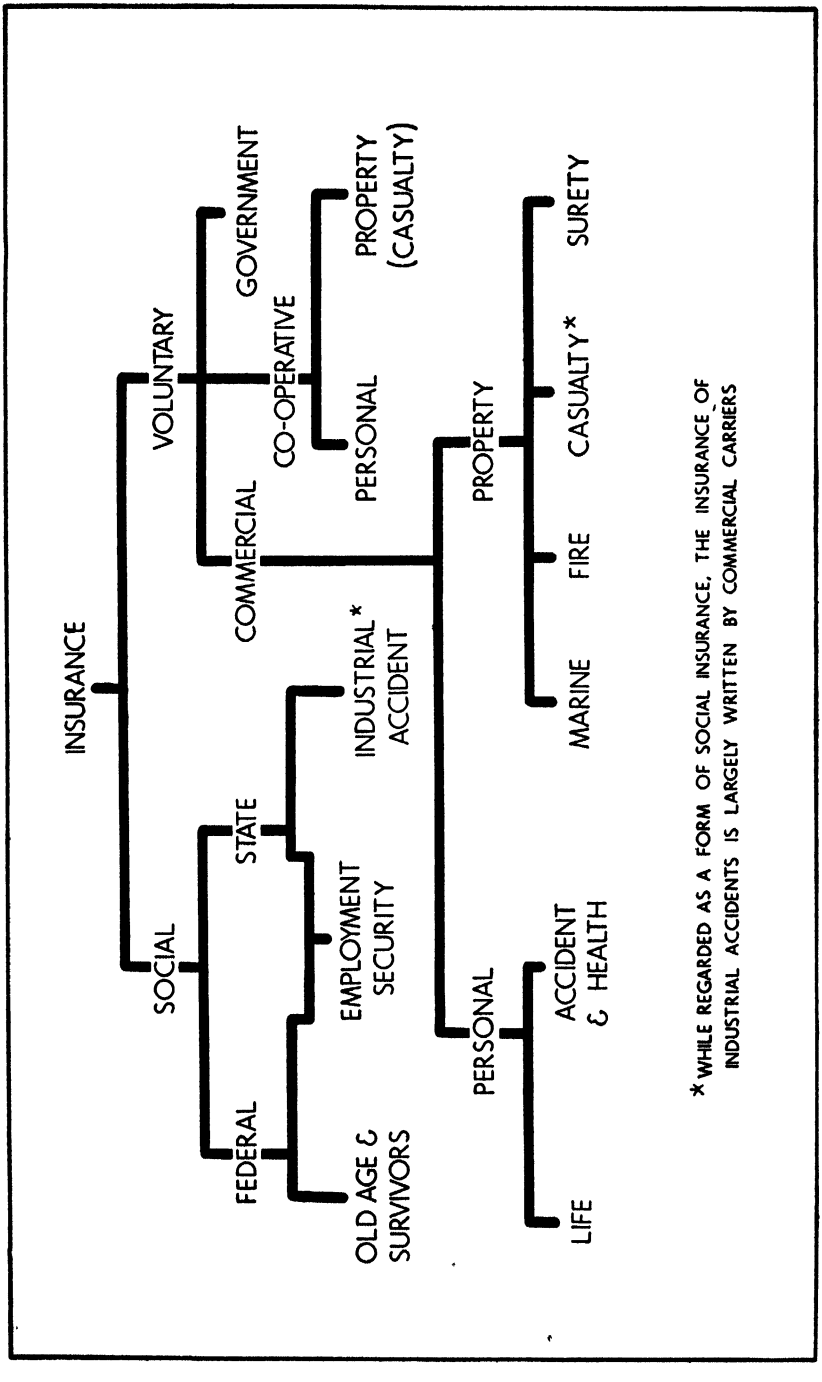


FIG. 1.—Relationship of social and voluntary insurance

of our economic structure is divided into two great parts: (1) social insurance, and (2) voluntary insurance. Social insurance and voluntary insurance together form a complete program. Figure 1 indicates the relationship of the various facilities available for risk bearing by insurance. The establishment of a line of demarkation between social and voluntary insurance has been the subject of much careful thought.

Social insurance is compulsory and is designed to provide a minimum of economic security for those in the lower income groups; it concerns itself primarily with the unfavorable contingencies that may follow accident, sickness, invalidism, old age, unemployment, and the premature death of the family wage earner. The term "social insurance" does not logically apply to the classification since all insurance, as will presently be noticed, in its essence possesses widespread social implications. The term, however, is now understood to apply to those insurance or quasi-insurance institutions organized by the state[6] and designed to bring economic security to the worker.[7] Social insurance does not undertake to provide benefits sufficient to maintain the worker's usual standard of life but has for its object the guaranteeing of a minimum of security when, through psychological or economic causes, the earnings of the worker become insufficient to meet his needs.[8] In contrast to voluntary insurance, social insurance is characterized by legal compulsion and state administration. It embraces large groups of citizens, and the cost is distributed sometimes among those who participate and sometimes among all classes of citizens. The compulsion element is predicated upon the experience that the poorer workman cannot or will not voluntarily purchase insurance, and the obligation of the government to contribute over and above what may be collected from other sources, such as the contribution of the worker and his employer, derives from the duty to protect the general welfare of its citizens.

Voluntary insurance, as the name indicates, represents those forms of insurance which are divorced from any element of compulsion and which are sought by the insured to meet a recognized need for protection. Voluntary insurance divides itself into three groups: (1)

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[6] Ely, Richard T., *Outlines of Economics* (5th ed.; New York: Macmillan Co., 1930), p. 652.

[7] Armstrong, Barbara N., "The Nature and Purpose of Social Insurance," *Annals of the American Academy of Political and Social Science*, Vol. CLXXI (November, 1933).

[8] Epstein, Abraham, *Insecurity a Challenge to America* (New York: Harrison Smith and Robert Haas, 1933), p. 57.

co-operative insurance, (2) voluntary government insurance, and (3) commercial insurance.

Voluntary insurance includes the vast business of insurance carried on by privately owned companies, and a wide range of insurance protection is offered by these organizations. In addition to the commercial companies there are certain nonprofit organizations that offer insurance protection to group members, such as those belonging to lodges or unions. These nonprofit organizations form a class known as "co-operative." They are not to be confused with commercial mutual companies which are in a sense co-operative but which are operated like other commercial companies, including the payment of salaries or commissions, and form in a true sense a part of the commercial insurance category. Only organizations that plan their operations strictly on a nonprofit basis fall logically into this group. Finally, the government appears in the voluntary field by making insurance available where the hazards are so great that private companies cannot well assume the risk, such as the insurance of soldiers' lives in wartime and of activities closely allied with the function of supervision, for example, the insuring of bank deposits. These insurance functions have important social implications but are all classed as voluntary, because there is no element of compulsion connected therewith, and the choice of whether or not insurance will be carried rests with the insured. In the field of voluntary insurance, commercial insurance touches the lives and activities in a way to require more frequent decisions and appraisal of hazards than any other form.

When we refer to "commercial insurance," we refer to the business offices to which we go to insure our lives and our property. Commercial insurance represents that division of the field known as the "insurance business."

Commercial Insurance. Commercial insurance is the most highly developed of all the forms of available insurance protection. A vast number of insurance forms have been developed to meet the needs of insureds for family protection and for the protection of business enterprises. When the term "insurance" is used, in the ordinary course, it is commercial insurance to which reference is made.

Commercial insurance, in contrast to the co-operative plans, receives its motivating force from the profit idea. Agents are located throughout the country. They present their insurance plans to

prospects and receive as their reward a commission on the business they produce. Officers of these companies are paid salaries for their services, and the operations of the companies are in every sense commercial enterprises.

Commercial insurance falls logically into two major classifications: (1) personal insurance, and (2) property insurance. Partly the outgrowth of historical development and partly the result of legal restrictions since entered into the statute books, commercial insurance in this country is written by companies specializing in particular forms of insurance. Chiefly these are life, fire, marine, casualty, and surety companies.[9]

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[9] The following coverages are obtainable through a multiple line insurance agency:

PERSONAL INSURANCE

Life Insurance. Term life; ordinary life, including single life, joint life, survivorship, contingent or survivorship; endowments; annuities immediate, including annuities certain, life of one person, joint life, survivorship, reversionary, guaranteed minimum, and combination; annuities deferred, including certain, life, and guarantee.

Accident and Health. The coverages are written separately and together on commercial, industrial, special automobile, workmen's group, non-cancellable, ticket, and travel forms.

FIRE, MARINE AND CASUALTY

Compensation, liability and property damage are written on the following forms: employers', public, general, sidetrack, contractual, teams', teams' property damage, contingent, protective, residence, medical, hospital, druggists', dentists', product, theatre, power boats, owners', landlords' and tenants'.

Sports policies are written on liability, property damage, and floater forms.

Elevator insurance is provided for liability, property damage, property loss, collision, passenger, freight, sidewalk, dumb waiter, and material hoists.

Plate glass insurance covers plates, art glass, mirrors, show cases, automobile, signs, memorial windows, residence glass, and lettering.

Burglary and robbery forms include residence (theft, larceny, holdup), mercantile (stock, safe, and messenger), bank (burglary, robbery, and safety deposit), general (paymaster, collectors' and salesmen), interior robbery, church and society, physicians' and dentists', hotel liability, and clubs.

Automobile forms include liability, property damage, collision, fire and theft, glass, windstorm, tornado, hail, lightning, earthquake, flood, explosion, water damage, chauffeur, non-ownership, garage liability, garage property damage, bus, trucks and contents, motorcycle, taxicabs, auto combination, riot and civil commotion, falling aircraft, and towing.

Aviation coverages include fire, windstorm, tornado, transportation, accidental damage, theft, robbery and pilferage, public liability (exclusive of passengers), liability to passengers, property damage, compensation, cargo, airport liability, and airmeet liability.

Power plant forms cover boilers, pipes, pressure vessels, engines, and electrical machinery as follows: property loss, property damage, liability, flywheel, and engine breakage, service interruption, the burning out of turbines and motors, explosion or cracking of heating boilers, use and occupancy and consequential losses.

Fire and allied lines include aircraft property damage, builders' risks (specific), builders' risks (automatic reporting), blanket mortgage (windstorm, earthquake, explo-

Personal Insurance. The two principal consequences of risk which insurance at the present time covers are: (1) the loss of earning power by persons and businesses, that is, the loss of property which will probably be acquired in the future, and (2) the loss of property which has already been acquired. It is with the loss of the earning power of persons that personal insurance is concerned.

The loss of earning power by persons results from their death, accident, illness, old age, childbearing, or loss of employment. The branches of insurance covering some of these contingencies have not, it seems, acquired names in keeping with their purposes, so that death is a contingency covered by life insurance, and disease is a contingency covered by health insurance. Unemployment insurance

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sion, and riot), blanket, errors and omissions, business interruption (fire, tornado, explosion and riot, earthquake, sprinkler leakage), commissions on sales, consequential loss, contracts on sales, deferred payment (merchandise), demolition, explosion (legal, liability), earthquake, fire—all forms, general covers, hail, leasehold, processors' risks, profits on finished goods, property damage, falling aircraft, rain, rents, rental value, reporting covers, riot and civil commotion, state floaters, sprinkler leakage, tenants' improvements, tornado, use and occupancy, and windstorm.

Private residences may be covered with the following insurance: fire, windstorm, earthquake, burglary, theft and larceny, plate glass, heating boiler, explosion, workmen's compensation, public liability, property damage, employers' liability, rental value, fine arts, and silverware.

Marine and all risk lines, including ocean and inland marine coverages, are written as follows: all risk (furs, jewelry, radium, fine arts), tools, bailees' customers (laundries, cleaners), bridges, camera floater, cleaners' customers, contractors' equipment, coastwise cargo, exhibition risk, export cargo, express shipments, fine arts, fur floater, furriers' customers, golfers' equipment, horse and wagon floaters, import cargo, inland marine, inland transportation, installation risks, intercoastal cargo, jewelry floater, lake cargo, laundry bundle, lodge paraphernalia, motor truck contents, musical instruments, ocean marine (hulls, cargo), parcel post, processors' risk, personal effects, protection and indemnity, radium, registered mail, rug cleaners' customers, salesmen's samples, scheduled property (floater), street clocks, surgical instruments, theatrical floater, tools, tourist baggage, transportation, trip transit, truckmen's cargo, and yachts.

Water damage forms cover plumbing, rain or overflow and industrial tanks.

Sprinkler leakage is a special form of water damage and the forms include property loss, liability, property damage, and use and occupancy.

FIDELITY AND SURETY BONDS

The more important surety bonds include the following: *Public Officials* (federal, state, county, city, village, township, and district); *Judicial* (fiduciary, appeal, injunction, garnishment, replevin, seizure, release, liens, removal, receivers, and assignees); *License and Permit Statutory* (permits, withdrawal, warehouse, elevator, license, custom house, revenue, mail route, post office, and immigrant); *Contract and Supply* (bid, completion, maintenance, and qualifying); *Special* (fulfillment replacement, performance, indemnity, and lease); *Lost Instruments* (stock certificates, bonds, policies, notes, warehouse receipts, and bills of lading); *Fidelity* (individual, scheduled, position bank, commercial, fraternal, and blanket); *Depository* (federal, state, municipal, private, and corporation); *Forgery* (depositors, commercial, and bankers' blanket); *Blanket Bonds* (bankers', mercantile, and baby blanket); and *Fraud Bonds.*

indemnifies for the loss of employment. Certain of the hazards bearing upon the loss of earning power have been discussed in connection with the coverages of social insurance. In the field of commercial insurance, however, life contingencies form the basis for one of its most important branches.

Most people are acutely conscious of the possessions for which they have expended time and serious effort to obtain. For that reason, spurred on by the thought of possible loss, they take every reasonable precaution for protection. It requires more thought to recognize the value of possessions that come to us as part of our inheritance, or without conscious effort or money payment on our part. It is for this reason that the importance of insuring life and health has frequently been overlooked.

During the early stages of the development of life insurance there were many who shunned the idea because it seemed to them improper at least, if not actually wrong, to receive a money payment at the death of someone dear to them. As a result, the wage earner frequently died leaving dependents destitute, because he failed to recognize that in addition to the family relationship, where sentiment and the emotions predominate, there is an actual monetary loss when the head of the family, who provides their maintenance, meets an untimely death.

Today we have been educated to realize the loss occasioned by the death of the wage earner, and life insurance to lessen the burden of dependents is more often than not a part of the program of every family. It is difficult to conceive of a young man with dependent children, possessed of good health and ambition, but lacking any accumulation of wealth, who is so thoughtless as to deliberately subject those for whom he has assumed responsibility to the possibility of actual want.

Aside from his life, the next most valuable asset possessed by any man is his health. Yet nine out of ten will insure a last year's automobile, a few pieces of household furniture, or other physical property they have acquired as a result of the expenditure of a few hundreds or thousands of dollars; but health itself, which is infinitely more valuable to the individual, they leave uninsured.

In estimating insurance needs, everyone ought to recognize, in order to be forearmed, a natural trait that tends to make us see danger as it affects others and at the same time to consider ourselves immune.

We know others die at all ages, but we postpone the thought of death touching ourselves. We know of young men and women cut down in their very prime. We know of the ravages of tuberculosis and are familiar with the terrifying treachery of pneumonia. We know likewise the terrible toll of accidents in death and permanent injury. Because, however, of this inborn trait that makes us underestimate the probability of misfortune, we tend to regard ourselves as exceptions, and consequently neglect the means offered for minimizing the serious consequences attendant upon loss of life or health.

Our two most valuable assets, life and health, are given to us gratis. We can protect them and preserve them; but, once lost, they are beyond replacement. Their value expressed in the hard terms of dollars and cents far exceeds any accumulation of physical wealth possible. It therefore becomes a matter of major importance that these two important assets be incorporated in the insurance program when that part of the family budget assigned to protection is being apportioned. To meet the hazards of interrupted earning capacity of the individual, commercial insurance offers life insurance, accident insurance, and health insurance.

Life, Accident, and Health Insurance. Life insurance in its simplest form undertakes to protect the insured's family, creditors, or others against pecuniary loss which may be the outgrowth of the death of the insured. The loss occasioned by death, against which life insurance attempts to provide protection, is the cessation of the current earning power of the insured. Applying an economic interpretation to the concept of death, it has been pointed out that the permanent loss of current earning capacity amounts to an "economic death." This being the case, from an economic standpoint, death may be (1) actual, (2) living, or (3) retirement. The first classification represents the so-called "casket death." Permanent disability from the economic standpoint is "living death," while from the same standpoint, living beyond the period of earning capacity represents "retirement death."[10]

To compare a person to a physical property, for the sake of determining his value for insurance on the basis of income or earning capacity, is purely an artificial step. The procedure has some use in underwriting for determining reasonable limits for insurance as well

[10] Heubner, S. S., *The Economics of Life Insurance* (New York: D. Appleton & Co., 1927), pp. 6–10.

as to emphasize to the individual that his life and earning capacity do in fact have a value. The life insurance business, however, recognizes the intimate family ties and all the complex relationships that arise therefrom and, as a result, recognizes a very real need and use for life insurance as a means for saving. Entirely aside from the desire to provide gifts for loved ones, as well as for charities and philanthropies, the individual must give thought to his own needs in old age.

Accident and health insurance provides indemnity for time lost because of accident or illness. While accident and health insurance is written by life insurance companies, accident and illness are also viewed as casualties, and casualty insurance companies write a large volume of this type of business. In addition to these carriers, there are a number of companies organized that limit their business to forms of accident and health cover.

Property Insurance. "Property," as synonymous with "ownership," is the right to use and dispose of "an animal or thing" for a legitimate end without the interference of any other person. In the category of property insurance is included every form that has for its purpose the protection of persons against loss arising from the ownership or use of property, as above defined. There are two general classifications of property insurance. The first undertakes to indemnify the insured in the event of loss growing out of damages to, or destruction of, his own property. The second form undertakes to pay damages for which the insured is legally liable, the consequence of negligent acts that result in injuries to third parties. The first of these is known as "direct loss insurance," and the second form is known as "liability insurance."

There are a great number and variety of coverages. The major groupings include: marine, fire, and casualty insurance. In addition, there are numerous miscellaneous forms such as the surety and fidelity coverages provided by corporate bonding companies and the highly specialized forms of insurance, including the insurance of real estate titles and of credit, that fall into none of the major divisions. Fire insurance companies may write marine business, and marine companies likewise write fire insurance business. Casualty and surety business may be written by the same companies. For this reason the field of property insurance is sometimes divided into two groups: (1) fire and marine, and (2) casualty, surety, and miscellaneous. It used to be the custom to refer to fire and marine insurance as property insurance

and to class casualty and surety business in a separate category. For the purpose of insurance underwriting the differentiation still exists, but for all practical purposes casualty, surety, and miscellaneous coverages are quite as much concerned with the protection of property as are fire and marine coverages. The distinction between fire and marine insurance as property insurance and casualty insurance as a separate branch is purely an artificial one, established primarily by the business of insurance and perpetuated by legal definition. Instead of referring to fire and marine insurance as property insurance, we may more logically say that property insurance carriers have been divided by the insurance business into two groups: (1) fire and marine companies, and (2) casualty, surety, and miscellaneous companies.

Fire and Marine Insurance. Fire insurance in its simplest form provides indemnity for direct loss or damage caused by fire. This basic coverage would provide protection, for example, if a dwelling house were destroyed by fire to the extent of the actual loss sustained. It would not cover, however, for loss of use of the dwelling. Likewise, in the case of a business where the premises or merchandise were destroyed, it would not cover for loss occasioned by the interruption of business. Losses of this latter nature are distinguished from direct loss in that they are termed "consequential losses." Fire insurance may now be written to cover not only direct loss but consequential loss as well, and the field has been extended to include a number of perils closely allied to fire or from which fire may be expected to develop. In this latter group are to be found policies insuring against loss caused by such perils as explosion, earthquake, windstorm, and riot. Damage to property from these perils frequently results in serious injury to the property insured, with further damage caused by fire following the disaster. It is not always easy to establish a line of demarcation between one cause and the other, and it was a natural consequence that fire insurance should be extended to cover both classes of risk. Thus we have in the fire insurance business policies covering direct and consequential loss and policies covering the so-called "side lines," such as explosion, earthquake, windstorm, riot, and the like.

Marine insurance, it has already been noticed, antedates the other forms of commercial insurance. Policies were written originally to cover against "perils of the sea." These included not only risks grow-

ing out of the operation of the forces of nature, but as well those arising out of the acts of man, as for example, barratry or piracy. Originally it was the intention to insure ships, cargo, freight, or other property on board a ship or vessel, Ultimately, insurers began to cover merchandise while on the docks awaiting shipment, and then the coverage was extended to include land transportation, from the point of origin and the shipment to the docks, and from the port of destination to the consignee, as well as the usual perils of the voyage. It thus became apparent that marine insurance covered perils of land transportation as well as perils of the sea.

It was a logical step to extend insurance coverage to shipments on land involving no ocean transportation whatever. This has become an important branch of the insurance business and is known as "inland marine insurance." There is a natural tendency to assume that inland marine insurance refers to water-borne risks of inland lakes and rivers. For a brief time the term was so used. As marine insurance is now classified, water-borne risks such as vessels, cargoes, and freight come within the scope of ocean marine underwriters. Land transportation risks, such as shipments by railroad, auto truck, express, parcel post, and the like, fall within the category of inland marine insurance. The following definition is indicative of the lines written by fire and marine insurance companies:

Fire and Marine.—On houses, buildings, and all other kinds of property against loss, damage, or damages by fire, lightning, or storm; to insure against loss or damage by water to any goods or premises arising from the breakage or leakage of sprinklers or water pipes; and to make all kinds of insurance against loss of or damage to goods, merchandise, or other property caused by fire, risks of transportation, or navigation, the action of the elements or adverse manifestations of nature, as well as all and every risk or peril to which the subject of insurance may be exposed, against which it is not contrary to public policy to insure, including every insurable interest therein or in the use thereof, or profit or income therefrom, or legal liability therefor, but not to include injury to the person nor loss caused by breach of trust.[11]

Casualty Insurance. The first type of casualty insurance written on a commercial basis in this country was accident and health insurance in 1850. This was followed by insurance covering accidents to steam boilers written in 1867. Both were specialized forms, and the cause of the loss in each case focused attention upon some form of

[11] H.R. 8793, 76th Cong. 3d. sess., *A Bill—To provide for the regulation of the business of fire, marine, casualty, and title insurance, and for other purposes*, p. 1.

accident involving a certain degree of violence. Around this nucleus developed that form of insurance to which the term "casualty" is applied.

Casualty as an insurance term is not easy of definition. Accepting casualty to mean accident, that is, a mishap proceeding from an unknown or unexpected cause, casualty insurance might be presumed to mean a contract whereby an insured who suffers loss or damage when an accident or casualty is the cause of the loss is reimbursed for the loss suffered. Since this definition might be made to apply to almost any form of insurance, it hardly serves as a guide for classifying coverages. By a process of elimination, this most recent of the major insurance groups is said to comprise those insurance coverages not to be classified as marine, fire, or life.

This process of elimination does not result in strict accuracy. Nor can a logical definition be readily devised. Resort, therefore, is necessary to the statutes for accurate definition, and because of this it follows that the definitions, while alike in principle, may differ in phraseology and minor detail in the different jurisdictions. The following is an example:

Casualty and Title.—(*a*) Upon the health of persons, or against injury, disablement, or death of persons resulting from traveling or general accidents by land or water, and against liability of the assured for injuries to employees or other persons; (*b*) upon the lives of domestic animals; (*c*) upon plate glass against breakage; (*d*) upon boilers against explosions and against loss or damage to life or property resulting therefrom, and against loss or damage resulting from the breakage of machinery; (*e*) against loss by burglary or theft, or both; (*f*) to guarantee and indemnify merchants, traders, and those engaged in business and giving credit, from loss and damage by reason of giving and extending credit to their customers and those dealing with them; (*g*) to guarantee titles to real property; (*h*) to insure against any other casualty risk which may lawfully be the subject of insurance, and which it is not contrary to public policy to insure: Provided, That this section shall not be construed as having any effect whatever upon the right or authority of any solvent company to make contracts of fidelity or surety.[12]

It will be noted that the foregoing definition specifically mentions "title insurance." By the process of elimination already mentioned, title insurance would be included in the casualty group, but because of the nature of the risk it possesses many of the characteristics of a guarantee. It will be also noted that the section allows casualty com-

[12] *Ibid.*

panies to write fidelity and surety business. While there are companies that specialize in these forms, it is quite the usual practice for casualty companies to write fidelity and surety lines.

Surety and Fidelity Coverages. Prior to the advent of corporate suretyship, a surety bond was defined as the promise of one person to answer for the debt, default, or miscarriage of another. The suretyship contract originated as a credit device and made its appearance in ancient times with the earliest development of business activities.

Corporate surety bonds were offered first in England during the early part of the eighteenth century, though this early project made no lasting mark in the field of insurance. In 1840 corporate fidelity business was established in England, and in this country the first American company was organized in 1853. It was, however, near the end of the century before the business assumed any marked importance in the insurance field.

In the strict sense, all corporate bonds in which a surety agrees to answer for the nonperformance of a principal are surety bonds. As a matter of practice, bonds are divided into two major classifications: (1) fidelity bonds and (2) surety bonds. In the case of a fidelity bond, the obligation of the principal is implied rather than contractual, and the bond undertakes to reimburse an obligee for loss of money or property growing out of the dishonest acts of the principal. The surety bond, in contrast, obligates the surety to hold himself responsible for the performance of an expressed obligation. In order to establish a claim under a fidelity bond, the principal would, of necessity, have been guilty of a dishonest act. In the case of a surety bond the coverage is much broader; and while a dishonest act may give rise to a loss, it is equally true that a loss may originate through negligence or lack of ability on the part of the principal.

With the development of corporate suretyship and the intimate association of this business with insurance, suretyship now is generally regarded as a branch of the business of insurance.

Social Insurance. Social insurance is generally conceded to have its point of origin in Germany under Bismarck, when state insurance was provided to cover the hazards of sickness and old age. In 1881 Emperor William in a message to the German Reichstag gave great emphasis to the necessity of furthering the welfare of the working people and presented bills calling for the insurance of workmen against industrial accidents and providing for a general organization

of industrial sick relief. Finally the message called for consideration of those disabled in consequence of old age or invalidism, and emphasis was given to the claim upon the protection of the state possessed by these people. A series of laws enacted between 1883 and 1889 had the effect of establishing the most effective system of social insurance up to that time.

The protection of workmen from the consequences of industrial accidents marked the first step in this country in the direction of social insurance. The first constitutional workmen's compensation act in the United States was passed in 1911 after bitter opposition on the part of many large employers. Compensation legislation had the effect of eliminating the need for the injured employee to prove negligence on the part of the employer, and the cost of accidents was regarded as part of the cost of production. While compensation insurance is written in most states by commercial insurance companies, the laws of the jurisdictions are such that with few exceptions some form of compensation protection is virtually compulsory, and even in those states where the employer still has the option of determining whether or not he will operate under the compensation law, the conditions pointing toward the acceptance of the law are so favorable that insurance is virtually compulsory. In some states, state funds are operated for the purpose of carrying on compensation insurance business, and in every state where the law is in operation provision is made for the administration of the compensation law and, in disputed cases, the determination of liability under the act by a state agency. Because compensation insurance is written largely by private carriers, it is generally regarded as commercial insurance; but because of its point of origin in social necessity, from a historical point of view at least, it must still be considered in connection with social insurance.

The enactment of the Social Security Act by the Congress, approved by the President on August 14, 1935, and amended in August, 1939, developed a nation-wide program of Social Security. As one of the established means for preventing future hardships and making for the security of working people and their families, the Social Security Act provides protection. The wage earner, himself, is enabled to provide for an income when earnings stop because of unemployment, old age, and death. Sight must not be lost of the fact that the Social Security Act goes far beyond the limitations of strict insurance and provides various other kinds of protection for needy old people,

dependent children, and the needy blind. The insurance feature, however, which provides (1) employment security, and (2) old age and survivors' insurance, is one of the most far-reaching social insurance programs ever undertaken anywhere, and millions of people in this country are within the scope of the protection.

Unemployment Insurance. The unemployment insurance feature of the Social Security Act is operated by the states with the federal government paying the costs of administration. Unemployment insurance benefits are paid out of a special state fund to unemployed workers who qualify under the state law. The state laws vary in some details, but in general they are based on one pattern. The amount of benefit payable is usually about one-half the worker's regular full-time weekly pay up to an established maximum. The maximum is usually $20.00 per week and there is a minimum set usually at $5.00 per week. In the case of partial unemployment the rule is to provide partial benefits. Payments continue for whatever number of weeks is set forth in the law, usually sixteen weeks. When a claim for unemployment benefits is filed, the claimant must register at a public employment office, and if employment is furnished him he is entitled to no benefits. If, however, after a certain waiting period no position is found, unemployment benefits begin. The waiting period varies and may be from two to three weeks. Bearing in mind that the state laws vary, the Social Security Board requires of the claimant for unemployment benefits that:

1. He must have been working on a job covered by the State law. This usually includes jobs in factories, shops, mines, mills, stores, offices, or other places of business and industry, including banks and building-and-loan associations. In about half the States the law applies only to concerns which have 8 or more persons on the pay roll during 20 weeks of the year. In the other States it also applies to smaller businesses.

2. He must have had a certain amount of pay or work on such jobs during the year or two before he lost his job or was laid off. Usually the amount of pay required is stated as so many times the amount of his weekly benefit payment.[18]

The state fund, out of which unemployment benefits are paid, is made up of contributions from every employer covered by the state law. These contributions are based on the pay roll of the employer

[18] Social Security Board, Federal Security Agency, *What Is Social Security, a Brief Explanation of the Social Security Act* (Washington: U.S. Government Printing Office, July, 1940), p. 7.

and in most states amount to 2.7 per cent. Credits may be allowed for a favorable unemployment experience. The income thus established is deposited in a special fund, following the requirements of the Social Security Act, and may be used only to pay unemployment insurance benefits.

The federal government assesses a tax rate of 3 per cent, but under the Social Security Act an employer operating under an approved state law is permitted to credit his contributions to the state unemployment fund to 90 per cent of the federal tax. This law has the effect of more or less fixing the state contribution of 2.7 per cent of the pay roll, which amounts to 90 per cent of the federal government assessment. The remaining 10 per cent is paid to the federal government. The federal government in turn, as has already been noted, bears the costs of administering approved state laws.

Old Age and Survivors' Insurance. The original Social Security Act passed by Congress in 1935 provided old age insurance for wage earners only, but under the terms of the amendment of 1939 the old age insurance system was enlarged to include the wage earner's family and not only after his death but also after he retires upon reaching sixty-five, or later.

The system is operated by the United States government and is strictly a form of contributory insurance, to be distinguished from the various public assistance programs which are designed to help those on the basis of need and not on the basis of their own contributions to an insurance system. The Federal Old Age and Survivors' Insurance system limits benefits to those who have earned wages on jobs covered by the law, and these payments are predicated in no sense upon the need of the beneficiaries. They have a right to the benefits of the law regardless of their financial status if, during their period of occupation, they have been covered by the insurance. There is nothing in the nature of poor relief or assistance to the needy in the system.

Under the plan, which is operated by the United States government, a trust fund is set up to which all wage earners who are covered and the employers of these wage earners contribute equally. The amount of the payment to which the wage earner is eligible depends upon the wages he has earned during the period he has been covered. If he has received a certain minimum amount of pay in a specified number of calendar quarters on covered jobs, the wage earner be-

comes eligible for monthly insurance payments at the age of sixty-five. When the wage earner becomes eligible, his wife also is eligible if she is sixty-five years old or, if not sixty-five at that time, becomes eligible when she reaches that age. Unmarried children are eligible if under sixteen or under eighteen if still in school. The Social Security Board divides those who may receive benefits into two classifications as follows:

(1) *Retirement payments*—
For the qualified worker himself after he reaches 65 and stops regular work;
His wife, if or when she is 65;
His children until they are 16, or 18 if still in school.
(2) *Survivor's payments* when a qualified worker dies—
For his children until they reach 16, or 18 if still in school;
His widow while she has such children in her care;
His widow if or when she is 65;
His dependent parents at age 65, if he has left no widow or young child.[14]

The system is administered by the Social Security Board and the United States Treasury. The board, among other of its responsibilities, keeps the wage records on which benefits are based. The Treasury, in turn, makes the collections and pays the benefits. Payments are shared by the wage earner and employers who make their contributions in the form of a special tax. The receipts from this tax are credited to a special fund known as "Federal Old Age and Survivors' Insurance Trust Fund" which is managed by the Secretary of the Treasury, the Secretary of Labor, and the Chairman of the Social Security Board. These taxes are regarded in the light of a premium paid for insurance, and up until 1947 represent 1 per cent paid by the worker and 1 per cent paid by the employer, based on wages up to $3,000 per year. The worker's taxes are deducted from his salary or wages, the employer contributes an equal amount, and this sum is paid quarterly to the Bureau of Internal Revenue. All wages reported by the employer at the time the tax is paid are credited to an individual's "Social Security account," and this account is kept in the interests of the worker by the Social Security Board.

In passing, it might be pointed out that the Federal Old Age and Survivors' Insurance payments are in no way related to any payments a worker may receive under unemployment insurance. Unemployment insurance is handled as a state program, and payments are made

[14] *Ibid.*, p. 11.

for unemployment compensation out of the state unemployment insurance funds. Old Age and Survivors' Insurance is a federal program, and benefit payments come out of the Federal Old Age and Survivors' Insurance Trust Fund. It has also been pointed out that old age assistance programs administered by the state in the way of monthly allowances to needy people are in no way related to the Old Age and Survivors' Insurance program.[15]

Co-operative Insurance. The term "co-operative" is applied to mutual associations usually operating under fraternal, employee, industrial, or trade union auspices. The co-operative idea is a continuation of the guild idea and the associations of working men that followed the guilds. The associations are organized without regard to the profit motive and represent, in fact, an effort to accomplish the ends of social insurance by private enterprise. This was recently pointed out in a study sponsored by the Federal Security Agency thus:

> With its emphasis on collective effort and common needs, cooperative insurance is the real forerunner of social insurance. Association for the common good and collective responsibility for the risks and dangers common to all members of the group have distinguished cooperative insurance from the beginning. As in social insurance, which is usually restricted to persons whose annual earnings are small, those who are insured by cooperative effort are in the main in low-income groups—laborers, artisans, and small tradespeople.[16]

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[15] Social Security Board, Federal Security Agency, *A Hand Book on Federal Old Age and Survivors Insurance as Provided in the Social Security Act,* (Washington: U.S. Government Printing Office, 1941), p. 5. Trends which the social security program are taking are evidenced in the so-called Wagner-Murray-Dingell bills. The latest of these, which carries the official name "Social Security Amendments of 1945" (S. 1050), was introduced in the Senate on May 24, 1945, by Senator Wagner on behalf of Senator Murray and himself. A similar bill was introduced in the House (H.R. 3293) by Congressman Dingell. The 1945 bill with certain variations follows the pattern of the Wagner-Murray-Dingell bill of 1943 which died in committee. The Wagner-Murray-Dingell bills provide not only for a national health program but contain broad and far reaching extensions of the social security system. Among the outstanding features are: (*a*) a program of grants and loans for construction and expansion of hospitals and health centers, (*b*) federal aid to states for extension of public health services, (*c*) federal aid to states for maternal and child health and welfare services, (*d*) federal aid to states for public assistance to the needy including the aged, blind, and dependent children, (*e*) provision for the federal operation of the United States Employment Service, and finally (*f*) a far reaching extension of the national social insurance system to include temporary disability insurance, personal health-service insurance, and medical care costs. The program would also be extended to provide protection classifications now not falling within the provisions of the act. There have been a number of proposals covering parts of this program filed by other members of the Congress as separate bills.

[16] Otey, Elizabeth L., *Cash Benefits under Voluntary Disability Insurance in the United States* (Federal Security Agency, Bureau of Research and Statistics, Report No. 6 [Washington, 1940]), p. 68.

In the United States the co-operative idea is evidenced primarily in the operation of fraternal societies, employee mutual sick benefit associations, and trade union benefit associations. The associations are ordinarily small and to a large extent local in their operation and management. Administration is, for the most part, in the hands of unpaid officers and committees elected by the membership. Fraternal societies are organized into local lodges, and all lodges within a state are organized into a grand lodge. A supreme lodge has jurisdiction over all the grand lodges, and a national fraternal congress unites all the societies. The tendency to bring together persons having a common racial origin or religious belief has manifested itself in these organizations. Lodge membership consists, with the possible exception of organizations for persons of foreign extraction, of small businessmen and skilled workmen rather than low-paid wage earners.[17]

Employee mutual sick benefit associations provide cash payments to members when sick, and sometimes at the time of death. Membership is limited as a rule to the employees of a particular industrial establishment, although some are organized on an occupational basis. Some of these associations are financed solely by the payments of the members, and in other instances the employer company contributes. Membership is usually voluntary, though in some instances all employees of an organization are required to join. In the case of trade unions, some unions have provided benefits for their members on a national basis, though the tendency more recently has been to permit management of such benefits by local organizations. Certain of the unions have organized insurance departments and provide for the writing of life and accident insurance. In addition to the foregoing, benefits in the way of hospital treatment, homes for aged and disabled, and special provisions for the treatment of tuberculous members have been provided.

To a certain extent the facilities of co-operative insurance run parallel with those offered by the commercial insurance companies. These organizations, however, are set up to meet requirements of special classes of persons and to provide, for the most part, an insurance program that may be represented as a minimum. There are a great many people who would not be eligible for the facilities of the co-operative organizations or would be eligible only for a limited participation.

[17] *Ibid.*, p. 70.

Government Voluntary Insurance. Insurance that falls into this category is principally distinguished from social insurance in that there is no element of compulsion. The various plans offered have wide social significance and are designed not only to benefit the immediate insureds but, through the various repercussions of the program, to benefit the entire community as well.

In this category are to be found such plans as the insurance of loans by the Federal Housing Administration, the insurance of crops by the Federal Crop Insurance Corporation, the insurance of deposits by the Federal Deposit Insurance Corporation, and the insurance of shares by the Federal Savings and Loan Insurance Corporation.

Under the terms of the National Housing Act, approved June 27, 1934, and as subsequently amended, the Federal Housing Administrator is authorized to insure two types of loans, those for repair, alteration, or improvement of real property and those secured by mortgages on residential structures. Among other purposes, the act is designed to create a sound mortgage market, to preserve property from deterioration, and to release funds for the construction and purchase of homes. Contingent benefits which flow from the operation of the act include the stimulation of employment and improvement of business in fields allied with the building industry, which in turn contribute their part to a healthy business activity generally.

Private insurance companies have, from time to time, offered policies covering crops, but the policies have been so limited in their coverage that the Department of Agriculture for many years has interested itself in the subject. Early in 1936 active research in crop insurance was recommended. In February, 1937, a bill was introduced in the Senate to provide crop insurance and, after hearings in both houses, was included in the Agricultural Adjustment Act of 1938 and signed by the President on February 16, 1938.

The plan provided for wheat crop insurance. The insurance is entirely voluntary with the farmer, who has the privilege of insuring either 50 or 75 per cent of his average yield. Premiums are based on historical and appraised crop loss records for individual farms, and the farmer is protected against all unavoidable hazards. These hazards include drought, flood, hail, wind, winter killing, lightning, tornado, insect infestation, and plant disease. Also included are losses caused by frost, fire, storm, animal pests, excessive or deficient moisture, and incursion of animals. To make the coverage in fact

"all risk," the provision, "any other unavoidable cause not excluded herein," is made a part of the contract. The specific exclusions under the act are neglect or malfeasance of the producer and failure to reseed in areas and under circumstances where it is customary to reseed. In addition, the following exclusions from the coverage appear: damage to quality and loss in yield caused by overpasturing; overplanting; use of defective seed; and failure properly to prepare the land, seed, harvest, thresh, or care for the crop.

The insurance was first applied to wheat crops beginning with the 1939 crop. In 1941 the act was amended to insure cotton crops for 1942 and subsequent years. The cotton insurance plan followed practically the same pattern as the wheat program. On December 23, 1944, new legislation was passed as an amendment to the Federal Crop Insurance Act.[18] In addition to the insurance of wheat and cotton, the new legislation also provides for trial insurance on other crops as sufficient actuarial data are available. The following crops are mentioned in the legislation, but authority is not restricted to these: corn, dry beans, oats, barley, rye, tobacco, rice, peanuts, soybeans, sugar beets, sugar cane, timber and forest, potatoes and other vegetables, citrus and other fruits, and tame hay. Federal crop insurance is now being written nation-wide on wheat, cotton, and flax with experimental insurance coverages on certain other crops. The insured farmer is protected against loss in yields below 75 per cent or 50 per cent of his average yield, depending on the plan chosen by the insured; crops insured on a trial basis may, as an alternative, be insured up to 75 per cent of the investment in the crop. From this it can be seen that the program is designed fundamentally for the purpose of creating catastrophe insurance and is intended to return only a minimum to the farmer which will enable him to stay in business in a case of severe loss.[19]

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[18] Because of restrictions of appropriated funds there was no crop insurance available to farmers on crops planted after July 31, 1943, until the enactment of the new legislation on December 23, 1944. In signing the Agriculture Departments Supply Bill in 1943, President Roosevelt evidenced regret that the crop insurance program was discontinued. At that time he said: "If we can make crop insurance work, it will, in my opinion, prove one of the greatest steps ever taken by the government toward making farming a sound and profitable occupation" (*The Standard*, July 16, 1943, p. 6).

[19] The purpose of the plan, it has been stated, is "the protection of the farmer through an all-risk insurance against total or crippling crop losses which is not and probably never can be furnished by the usual insurance channels, and to educate the farmer as to the benefits of insurance so that he will be all the more ready to take on insurance against hail, windstorm, or other specific hazards which is offered in the usual

The social implications of the program have been thus expressed:

As a national program, crop insurance is designed to bring security to the individual farmer and, as a consequence, to bring more stability to agriculture as an industry. Financial security for the farmer will enable him in many cases to continue farming, when otherwise he would be compelled to find other means of livelihood because of failure to meet his debts or inability to live on his income in a year of crop failure. Thus it may eliminate a part of the shifting in the farm population and perhaps reduce some of the migratory movements that have been so pronounced following the drought years. It should tend to stabilize local business conditions in farm communities by providing purchasing power in years of crop failure; it should stabilize local financial institutions by enabling farmers to pay their debts with greater regularity; and it should stabilize land and other property values by reducing foreclosures.[20]

The federal crop insurance program is not a subsidy program and it is expected that, over a period of years, premiums collected will be sufficient to pay indemnities. The costs of administration borne by the government are regarded as a contribution toward the stabilization of agriculture.

The Federal Deposit Insurance Corporation insures deposits in banks entitled, under the Banking Acts of 1933 and 1935, to the insurance benefits of the corporation. The Federal Savings and Loan Insurance Corporation performs essentially the same function for shareholders in federal savings and loan associations and eligible state-chartered institutions that apply for the insurance and are approved. In both cases the limit of eligibility is $5,000. The value of guaranteeing deposits in banking institutions and investments and savings in loan institutions is readily apparent when it is realized how important to the credit structure of the country is a general confidence in the solvency of banking institutions.

In the field of life insurance the government made a notable contribution by providing coverage to the military forces of the United States under an act of Congress approved October 6, 1917. This act is being administered by the Secretary of the Treasury through the Bureau of War Risk Insurance of the Treasury Department. At the

insurance channels. . . . . It is not built for or intended to take the place of small, partial, or total losses on a part of the acreage, referred to as spot losses, against which the farmer can get 100% protection through the insurance channels" (J. Carl Wright, Manager of the Federal Crop Insurance Corporation, quoted in *The Standard*, August 3, 1945, p. 11).

[20] Rowe, William H., and Smith, Leroy K., "Crop Insurance" in *1940 Year Book of Agriculture*, U.S. Department of Agriculture (Washington: United States Government Printing Office, 1941), p. 757.

outbreak of World War I there was grave apprehension as to the effect of war service upon mortality experience, and new policies were issued by life insurance companies only if an extra premium was paid. The government in providing war risk life insurance undertook to assume the excess of mortality attributable to war and to provide insurance to the members of the military and naval services at cost, using as a basis for its computation the same data used by the standard life insurance companies in computing their rate schedules. The total war risk insurance in force at one time was in excess of $40,000,000,000, but with the termination of hostilities much of the insurance carried during the period of emergency was allowed to lapse.

The National Service Life Insurance Act of 1940 created National Service life insurance and made it available to those who were on October 8, 1940, members of the military and naval services, including the coast guard, and to persons entering the services after October 8, 1940. There were received, up to and including September 30, 1941, approximately 603,500 applications for National Service life insurance in the amount of $2,049,087,690, an average of $3,395.34 per application. At the end of 1945 National Service life insurance in force on veterans and servicemen was approximately $96,000,000,000. Government life insurance is still available to veterans who can submit proof of insurability.

There are a number of state insurance projects, notably in the field of compensation insurance. Some states have felt that with the enactment of workmen's compensation laws providing for payment of industrial accidents, the state should likewise provide the means for insurance. While state funds have been set up for the purpose, the greater part of workmen's compensation insurance is written by commercial companies.

In one state, Wisconsin, the state is authorized to issue policies of life insurance. The statute enacted in 1911 called for the establishment of a fund to provide for the writing of life insurance policies insuring the lives of residents of the state. Here again this form of insurance is written only in a limited degree by the state, and the great volume of life insurance is handled by commercial companies.

FOR REVIEW

1. It is sometimes stated by those interested in the business of insurance that the development of social insurance is in fact a threat to the insurance business. Those who express this opinion evidence a fear that some day all the business

of insurance will be handled by the government. As a point of departure for discussion, indicate whether or not in your opinion the government's participation in the field of insurance constitutes a threat to the private insurance business.

2. In effecting an insurance program, the owner of a business must, of necessity, give consideration to the various risks involved in the conduct of the business. He will then buy insurance to cover such risks as he deems should be insured. B contends that in cases in which there is a loss but a possibility of collecting from a third party, to insure such a hazard is an unnecessary expenditure. A simple example of such a risk is the insuring of one's own car against collision damage. According to B's theory, the third party causing the damage to his automobile should be made to pay. Therefore, insurance is unnecessary. Discuss.
3. In connection with the Social Security program, one of the major methods for attaining the objective is to be found in federal grants-in-aid. These grants-in-aid go to the state for certain kinds of relief, such as: pensions for the needy, aged, and blind; mothers' pensions; maternal and child health services; aid to neglected, crippled, and other handicapped children; and public health protection. To what extent, if any, may these payments be regarded as insurance?
4. Justify the necessity from a social standpoint of a government insurance program in view of the fact that federal and state grants already are provided for the destitute aged.
5. It is sometimes said that a state can enact an unemployment insurance law best suited to its individual needs. What is the necessity for the federal government setting up minimum federal standards?
6. The statement is sometimes made that the cost of compensation, as well as of old age insurance, is not an actual additional cost. In one way or another these costs have always been borne. Discuss.
7. The Social Security program in this country received impetus during a period of depression. It has been contended by some that should a period of prosperity return, such as witnessed between the years 1920 and 1929, less interest would be evidenced in the program because there would no longer be a need. Is this correct?

CHAPTER III

SOCIAL VALUE

INTRODUCTION. It has already been noticed that there are certain forms of insurance, characterized primarily by their benefits to the lower income groups and by the fact that they are compulsory and administered by the government, that are known by the term "social insurance." It has also been pointed out that all insurance is essentially social in its ends. It is hard to visualize the far-reaching effects of the annual distribution of nearly four billion dollars in benefits to holders of insurance policies in commercial companies. It has been estimated that the thrift and foresight of individuals and business institutions, purely by the voluntary purchase of insurance, made possible the flow of $116 per second every night and day for the 366 days of 1940.[1] It is estimated that, including beneficiaries, over a hundred million Americans have a stake in life insurance alone. Commenting upon the far-reaching effects of these vast payments, Adams has stated:

> In no other land, in no other time, have a people through individual foresight and continued self-denial erected a monument of relative magnitude to national thrift. Never has so vast a portion of a population voluntarily made like sacrifice to support an institution of similar purpose conceived and conducted as a private enterprise. It is incomparably the greatest savings institution in the world. It is the chief channel through which a self-reliant race transmits to succeeding generations the material means of self-reliance. It endows free men with economic independence without which there is no real liberty and generates spiritual values in the process. Directly or indirectly it serves the whole people, for the incidence of its benefits extends to the entire nation.[2]

When we add to the life insurance benefits the indemnification for losses paid by the other forms of insurance, it can readily be seen that there is scarcely any family that does not benefit from this vast flow of funds. Nor are those who are the immediate recipients of insurance payments the sole beneficiaries. This flow of funds circulates through every community in the land and helps to pay the rent, the

[1] *The Insurance Almanac* (New York: Weekly Underwriter, 1941), p. 1205.

[2] Adams, Claris, "Life Insurance—A National Asset," *Proceedings of the Thirty-fourth Annual Convention of Association of Life Insurance Presidents* (New York, 1940), p. 98.

grocer, the doctor and contributes to every form of business enterprise to an extent that it is impossible to trace.

The importance of insurance as an institution and its contributions to the social development of the times are well-nigh incalculable. Nor is it lacking its panegyrists. No less eminent writer, teacher, and philosopher than Josiah Royce has said:

> Furthermore as experience shows, the insurance principle comes to be more and more used and useful in modern affairs. Not only does it serve the ends of individuals, or of special groups of individuals. It tends more and more both to pervade and to transform our modern social order. It brings into new syntheses not merely pure and applied science, but private and public interests, individual prudence, and a large regard for the general welfare, thrift, and charity. It discourages recklessness and gambling. It contributes to the sense of stability. It quiets fears and encourages faithfulness.[3]

Dr. Carleton Thomas Lewis says:

> It [insurance] has done more than all the gifts of impulsive charity to foster a sense of human brotherhood and of common interests. It has done more than all repressive legislation to destroy the gambling spirit. It is impossible to conceive of our civilization in its full vigor and progressive power without this principle, which unites the fundamental law of practical economy, that he best serves humanity who best serves himself, with the golden rule of religion, "Bear ye one another's burdens."[4]

Security Wish Motivating Factor. The prime motivating factor that contributes to the drive for certainty and hence to the development of insurance is the wish for security. The force of this wish drives the individual to provide for his physical needs such as food, water, and shelter. He protects himself against human enemies, enemies of his country, or any situation that may affect his social position. When a man is in danger of losing his home, his health, or his standing in the community, he experiences apprehension and, if the risk is great, fear. Apprehension and fear are unpleasant mental states. Instinctively the individual seeks to avoid them.

The drive for security manifests itself in many ways. The traveler in remote and dangerous countries arms himself for his protection. Police departments are organized in established communities for the same purpose. Fire departments are designed to prevent losses to property by fire. Flood control projects control the abnormal flow of

[3] Royce, J., *War and Insurance* (New York: Macmillan Co., 1914), p. 2.

[4] Lewis, C. T., "Insurance," *Encyclopaedia Britannica* (11th ed.; 1910), Vol. XIV, p. 658.

water. Measures taken to prevent loss are a natural consequence of the continued search for security. They are, in fact, a part of the process of man's adjustment to his environment. Finally, as a part of the process of effecting security, insurance finds its place.

Man, as distinguished from all other creatures, is endowed with the faculty that permits him to look into the future to the end that he may arrange for a rational and orderly existence. Therefore, not only is he concerned with his immediate needs for food, sustenance, and protection, but he is likewise concerned with his needs for the future. Thus, the individual who has ample for the present day is interested in providing for his welfare in old age when his own productive capacity has diminished or has passed entirely. He is interested in providing for his family in the event of his untimely death. He is interested in preserving his possessions so that they will continuously be available for his use. Fear or apprehension may, therefore, be present when the future security of the individual is uncertain.

The wish for security is satisfied and the mental states of apprehension and fear are eliminated when the uncertainty concerning threatening dangers no longer exists. As has already been noted, there are a number of ways of eliminating the various types of uncertainty involving chance of loss. The place occupied by insurance is of immediate interest.

Inhibiting Effect of Security Wish. The drive for security prompts caution; it causes the individual to avoid speculative ventures involving the chance of large profits with the possibility of large losses and to seek, instead, a more modest reward with the chance of loss minimized. It follows, therefore, that the drive for security discourages new adventure and the entering upon new and untried projects. The building of great bridges, buildings, factories for new products, and the like are all attendant upon risks, some of which are apparent and others of which are unknown. Voyages of discovery would have never been made except that the desire for adventure and new experience was greater than the urge for security. In the field of economics, business risks frequently carry with them no compensating satisfaction other than the possibility of large rewards. To the end that this is so, and to the end that the drive for security influences the behavior pattern of the individual, new experiments, new ventures, and business projects involving risk are likely to be

discouraged. To the extent that insurance relieves an individual entering upon a project weighted with danger of loss and changes the possibility of loss to a certainty that losses will be measured by the insurance premium, this inhibiting effect of the security drive on new enterprise is eliminated.

Security in Mutual Contributions. In the earliest stages the co-operative principle was circumscribed by the confines of the particular group concerned. In the patriarchal family the aged, the infirm, the sick, and those otherwise unfortunate found protection and security in the family group. Where possessions were held in common, naturally a loss affecting cattle, crops, or buildings rested heavily on no individual until the loss reached a proportion that involved all or a considerable part of the group's possessions. Individual families developed into tribes and groups of families into villages. However, in the beginning it was to these groups—the family, tribes, and villages—that the individual turned in time of disaster.

Whenever the status of the individual was such that the family or tribe could not furnish the protection deemed essential, the search for security went on. In the course of time, with the development of private ownership, voluntary contributions were made whenever a member of the group suffered loss. Contributions were first made, it is presumed, out of kindness of the heart. But because the group member could not know when the time would come that he himself would be in a position of need, self-interest became a factor and voluntary contributions became a matter of community custom. Each member of the community was forced by the pressure of public opinion, as well as by the thought of his own possible future needs, to contribute to make good his neighbor's loss. This plan of voluntary contributions has come down to us in modern times and is not infrequently found in operation in rural communities. It is sometimes known as "insurance by compulsion."

A Stimulus to Protection. Fire insurance companies recognized very early that their success depended in large measure upon their ability to furnish protection at reasonable cost. They therefore systematically encouraged protection and then undertook to co-operate with insureds to minimize or eliminate serious fire hazards. They also encouraged desirable property improvements and better types of building construction through giving credits on rates.

Fire insurance companies have also studied fire protection requirements of cities and towns, have made recommendations concerning the installation of water supply and fire-fighting apparatus, and have organized fire-fighting forces in order to reduce the cost of insurance. Such work as this, followed by periodic inspections and reports, requires a large personnel.

Liability companies make frequent inspections of insured property and recommend the elimination of features that they know to be hazardous. Companies which carry compensation insurance make periodic examinations of the premises of the insured to see that safety devices are installed, that they are properly used, and that working conditions are such that accidents can reasonably be expected to be reduced to a minimum.

An indication of the extent to which this feature of prevention is carried is to be found in the services rendered by the companies insuring boilers against explosion. As a matter of fact, a substantial part of the premium charged is set up to cover the expense of inspection. Periodic examinations of the insured boilers are made. Safety devices are tested, and the plant is carefully checked in operation. At least once during the year, usually during a period when the boiler would normally not be in operation, a thorough inspection is made, including pressure tests, and examination for scale, weak or rusting tubes, defective safety devices, and other weaknesses that are the outgrowth of age or neglect. A carefully prepared report is then submitted to the insured. Owners of mills and plants operating high pressure boilers, as well as owners of heating boilers, frequently buy insurance primarily to avail themselves of the inspection service without particular regard for the indemnity feature of the contract.

Contributes to the Conservation of Health. Closely akin to the protective measures instituted by property insurance companies are the numerous educational campaigns instituted by life insurance companies in the interest of their policyholders in particular and in general for the benefit of the public at large. Large sums have been expended in advertising, and a great deal of publicity, through the use of bulletins and other advertising matter, has been given to such subjects as first aid, personal hygiene, sanitation, and disease prevention. Some companies offer free periodic medical examination to policyholders. Medical examinations are made with a view to detecting weaknesses in time to make prevention or cure a possibility.

Life insurance companies have been instrumental in promoting legislation aimed to improve health conditions and standards. They have directed the attention of communities to the means for obtaining pure milk and have pointed out the necessity for ordinances governing milk distribution. As part of the campaign for distributing information, the companies have made use of the radio, newspapers, magazines, the theater, and personal contact. While life insurance companies do not make any claim for exclusive credit, their activities have unquestionably contributed to the improvement in health conditions and the accompanying extension of the average term of life.[5]

Protects Family from Disintegration. Because life insurance provides available funds at a critical time, it is often unquestionably the means for keeping families together that otherwise might be broken up. The unfavorable effects of family breakdown manifest themselves in the form of juvenile delinquencies, ill health, child labor, and mental breakdown.

It is well known to sociologists that a widowed mother left to carry on without adequate resources frequently loses control of her children. Worry and overwork frequently lead to broken health which not infrequently results in inadequate care and attention for the children. When the mother loses control over the children, or when the family unity is broken because of poverty, juvenile delinquency not infrequently manifests itself.

Entirely aside from the danger of delinquency, the need for resources to support the family often makes it necessary for the children to engage in some remunerative occupation. Opportunities for children to work under favorable conditions are rare indeed, and they are often found employed under conditions that injure their health and prevent their developing to the full extent of their capacities. Long hours working on farms or as newsboys, delivery boys, bootblacks, and the like afford, in many instances, an unfavorable environment in which to develop, and there is also great danger of injury from accidents. In some instances, as in the case of industrial employment, children are exposed to dangerous substances with the result that they contract industrial diseases. All these situations are most unfavorable from a social standpoint and are rarely found when adequate financial resources are available.

[5] For a further discussion of the contribution of insurance to the prevention of loss, see Chapter V.

Aside from the consequences of delinquency and ill health, an equally severe result frequently manifests itself in the form of nervous disorders. The child who is overworked, with the consequent lowering of physical stamina, is frequently harassed by worry and fear when placed in unfamiliar surroundings. Not infrequently such situations result in the development of nervous disorders. This is particularly the case when a child is forced into unusual and difficult situations during the period of early adolescence.

Affords Peace of Mind. It has already been noticed that the prime motivating factor that contributes to the development of insurance is the instinctive urge referred to by psychologists as the "security wish." A wish in the psychological sense may be the outgrowth of attitudes, or it may create new attitudes. A wish tends continually to drive an individual toward its satisfaction; an unsatisfied wish creates a tension which manifests itself to the individual in the form of an unpleasant reaction. In the case of a security wish, this may take the form of fear or apprehension.

Security banishes fear and uncertainty. The first, and perhaps the most important, concern of the individual is the provision of food, water, shelter, and other creature comforts for himself and his dependents. Next, he is concerned with avoiding sickness and physical dangers. Lastly, he wishes to maintain his social position and give his children every possible advantage of education and training.

The possession of a home, an automobile, and an income producing investment or business may be sufficient to afford the protection desired. But the knowledge that fire, windstorm, automobile accident, or other catastrophe entirely beyond the control of human agency might by a single blow sweep away the accumulation of a lifetime defeats the aim for the fullest degree of security through the introduction of uncertainty. The wish for security, therefore, is to a degree frustrated, and unpleasant reactions in the form of anxiety result.

By means of insurance, however, much of the uncertainty that centers about the wish for security and its attainment may be eliminated, with the result that there is a consequent increase of gratification of the fundamental psychological drive; accompanied by a pleasant state of relaxation and peace of mind.

Provides Basis for Credit. The businessman who sets out on a particular undertaking might, it is conceivable, be willing to assume

personally a considerable degree of risk. Large enterprises often build up their own insurance fund by regularly setting aside money for the purpose. In other cases, when no fund is planned, owners are willing to assume risks without protection. Self-insurance projects, however, rarely satisfy the lender when physical property is offered as security on a credit risk. If the loan is in the nature of a bond issue, the trustee will insist that the property offered as security be adequately protected by sound insurance. On bank loans, one of the items of information required on financial statements deals with insurance coverage, which must be adequate before the credit will be extended.

Again, if the purchaser of a piece of real estate, unable to pay for it in full, gives a mortgage to secure the balance of the purchase price, he will be required to insure the property sufficiently to cover the interest of the mortgagee. The lender ordinarily holds the policy until the loan is paid. Securities have been floated, and a ready market has been found when interest, principal, or both were guaranteed by the insurers.

The extent to which a creditor may go in requiring insurance before he advances money is limited only by the insurance coverages available. When accounts receivable are offered as an element in the assets of the borrower, credit insurance may be required. When a building in the process of construction is being financed, contractors' construction and completion bonds may be required. Liability coverages, workmen's compensation, fidelity coverages, burglary and theft insurance may all be required to minimize risks attaching to the business or undertaking before credit is obtainable on satisfactory terms.

Credit executives are increasingly insistent that those to whom credit is extended on open account provide themselves with adequate insurance. There are many who associate credit losses and insolvency with business incompetence. The experienced credit executive is less concerned with the probability of loss from this source than he is with the probability of insolvency of the creditor due to some unforeseen business catastrophe that might be covered by insurance.

It is known that floods, earthquakes, and tornadoes that reach the proportions of catastrophes carry with them a trail of credit losses that reach to all parts of the country. Strikes and riots may precipitate a credit crisis, as may the fraudulent acts of a trusted employee.

Frequently credit is extended on the managerial ability of some one key man in a business. The life insurance companies have recognized the importance of such individuals to a business by providing insurance to indemnify for his loss in the event of untimely death. From the examples here indicated it is at once apparent that in extending credit to the going concern, the credit manager is interested not alone in the present standing and prosperity of the business but the extent to which the business asking for credit has protected itself against future unfavorable contingencies. The means by which this protection is effected is insurance.

For this reason, before credit is extended it is frequently required that adequate property damage and liability coverages, workmen's compensation insurance, fidelity coverages, burglary and theft insurance be carried by the borrower.

Gives Immediate Benefit of Accumulation. Every individual possessed of reasonable foresight and prudence plans for his future needs and for the needs of those depending upon him. He may wish to leave an estate sufficient to support his wife and educate his children. With reasonable success and freedom from unusual misfortune, he may compute that an estate equal to a specific sum may be accumulated during a period of years. If he were certain that he would live so long, enjoy good health, and be able to produce without interruption, the sum might be accumulated. If, however, instead of attempting to accumulate and administer the sum himself he buys a life insurance policy for the desired amount, an estate is created at once and will be forthcoming when needed.

Again, the owners of a business might foresee contingencies that would bring great loss. To meet such situations they might decide to set aside annually a reserve, but they could not be assured that no loss would occur until the fund was accumulated. It is possible, however, by making an annual payment, to secure immediately through insurance the use of a fund already accumulated to meet such a contingency.

Provides Fixed Capital. In the course of accomplishing the purposes for which they are established, insurance companies accumulate vast sums of money. The investment of this money provides a source of capital that in no small degree simplifies the processes of economic development.

Because the accumulation of insurance funds is primarily in the

nature of reserves, investment in long-term securities is permitted. Hence, in the investment portfolios of insurance companies are to be found immense holdings of railroad, public utility, and industrial bonds and real estate mortgages. In this last category are to be found mortgages on farms, individual dwellings, apartment houses, hotels, and office buildings. These range in size from individual loans of a few thousand dollars to corporation loans of scores of millions which are often so great that even the largest banks would hesitate to grant them.

The gathering together of billions of dollars from every corner of the land and the making of these vast sums available for long-term borrowers have without doubt stimulated the development of productive enterprise. When we view the vast dams for the generation of power, the far-flung railroads, the great skyscrapers, and the vast industrial developments, we pay no undeserved tribute to insurance as an institution if we attribute to it a fair share of the credit for making the necessary capital available.

Protects the Home. Most of the houses purchased in this country are mortgaged at the outset to secure a loan for part of the purchase money. Repayments are so planned that at the end of the term the home will be owned without encumbrance. Moreover, just as the lender of the money on the mortgage wishes the value of his security to be protected and will require the necessary property insurance, so will the family producer wish the home guaranteed to his dependents in the event that they are deprived of future anticipated income through his untimely death. To accomplish this, while the house payments of interest, principal, and property insurance are being planned and budgeted, an additional sum for a life policy equal to the mortgage may be included.

Offers Means of Investment. While not a primary function of insurance, investment service has, nevertheless, developed into one of its important benefits. Individuals unwilling or unable to handle their own funds have been pleased to find an outlet for their investment needs in the various policies offered by life insurance companies. Endowment policies, annuities, and retirement income contracts find a place in this category, as do those contracts that provide monthly payments to beneficiaries in lieu of lump sum settlements.

Renders Professional Service. The business of insurance today is a highly technical one and is becoming increasingly so with newer

developments. The necessity for securing the assistance of a trained expert to analyze the insurable risks that attach to an individual or to a business enterprise is becoming increasingly recognized. The insurance business itself is providing this expert assistance and is more and more insisting upon highly trained representatives to render professional service to insureds as well as to secure business for the companies. Schools have been established at great expense for the training of field representatives, and insurance companies encourage their employees to take courses that have been established for the purpose. Educational institutions of higher learning are co-operating with the insurance companies in providing a broad academic training designed primarily for those who would enter the field of insurance for a lifework. Not only do these institutions give highly specialized courses but they have built up curricula designed to provide the necessary background in economics, finance, government, sociology, and law. The services of these highly trained experts are available to the buyers of insurance without cost other than the payment of the insurance premium. Unlike the attorney, the physician, the accountant, or other like specialists who must be remunerated for their services on a fee basis, the insurance agent or broker who arranges an insurance program for a client is compensated by the insurance companies, and no specific charge for this service is made to the client himself.

Contributes to Education. The business of life insurance has given special attention to the matter of providing funds for the education of children. Following the death of the wage earner, it often happens that children are deprived of educational facilities which in the normal course they might expect to receive. They are sometimes obliged to withdraw from school altogether, or in other circumstances they are obliged to curtail their programs by eliminating college from their plans or substituting a less expensive program for the one contemplated. The business of life insurance has foreseen this contingency and provided a number of forms of insurance designed to make possible the continuation of an educational program that might otherwise have been interrupted because of the untimely death of a parent.

Another aspect of the question presents itself in the use of life insurance as collateral for a loan. A student who finds himself short of funds frequently undertakes to negotiate a loan for the completion of his educational program. Often he has nothing to offer for col-

lateral other than a good reputation and his future prospects. The reputation and prospects might well be regarded as ample security for a loan were it not for the uncertainty that attaches to life's duration. The factors of reputation and prospects protected by life insurance have made possible the continuation of an educational program that might otherwise have been interrupted for lack of funds.

Eliminates Dependency. A casual survey of the problems of social pathology indicates that many unfortunate developments centering in family disorganization and personal demoralization are economic in their inception. The difficulties of the destitute widow with children need no elaboration. The child's chances for future success are immeasurably lessened by a lack of means, and if left an orphan he may be destined to institutional care. Likewise, old age, carrying with it a lessened capacity for productive enterprise, brings reduced standards of living, demoralization, and frequently the almshouse. Less painful to consider, nevertheless distressing, are those cases where dependency, because friends or relatives are in a position to assist, does not involve public or institutional assistance. Economic independence serves to forestall social maladjustment with the attendant demoralization of family or individual. A properly effected insurance program will contribute to the maintenance of economic independence.

Stimulates Saving. Strictly speaking, the insurance contract is one of indemnity; but since certain life insurance policies have added to the insurance feature of the agreement clauses in which the element of saving predominates, this factor should not be overlooked. When an insurance policy is used as a means of saving, the premium is presented in the nature of an obligation that is due, and a realization of that fact prompts the insured to fulfill his contract even if sacrifice is necessary.

In addition to giving consideration to the uncertainties of life's duration, life insurance definitely involves an element of saving. Some forms of life insurance give particular emphasis to this savings element and thereby enable the individual to combine a program of insurance and savings. The advantage of a life insurance program with a savings feature, in contrast to a savings plan outside of life insurance, is to be found in the fact that life insurance premiums become due regularly and the program is systematized. It is a matter of common knowledge that good resolutions are easily broken. The

individual who plans to save $100 monthly by depositing it in a savings bank could easily omit a month or two and then abandon the program entirely. In the case of life insurance the situation is different. The premiums are frequently regarded by the insured in the nature of a debt or an obligation that must be met. If the insured is tempted to allow his insurance to lapse, the representative of the company is present to restate the arguments that originally prompted the establishment of the program. This element of personal follow-up by company representatives added to the tendency on the part of the policyholder to regard the premium payment as an obligation has the effect of giving stability to a savings program instituted through life insurance that is not ordinarily found in any other place.

Fosters Economic Independence. In giving emphasis to thrift, life insurance encourages self-reliance in the case of the individual. The educational programs of insurance companies have gone far to establish in the minds of individuals the advantages of taking steps to provide for their own future needs, rather than to rely upon government doles and charity when the need manifests itself.

The element of self-sacrifice is inherent in life insurance programs of individuals. Unquestionably, public charitable expenditures would be tremendously increased in this country but for the annual disbursements made by life insurance companies. Through the agency of life insurance the cause of dependency is removed, and the institution serves as a means for preventing a social malady rather than as a cure.

Provides Security for Women Seeking Careers. Many women do not marry, but enter upon a career entirely independent of family life. The necessity for providing for immediate needs, as well as for future independence when the earning capacity is diminished because of old age or sickness, is a problem that must be recognized by these women if they would not be faced with ultimately becoming a burden upon relatives or objects of charity. The problem of future economic independence may be solved through the agency of life insurance. For those covered by the act, the Social Security program provides a certain sum, dependent upon earnings, for retirement. This retirement income may be augmented by an insurance program designed to provide income payments on a monthly basis at a predetermined retirement age. Provision may also be made for payments in the event of sickness or accident. The knowledge that these

needs are provided for tends to develop a feeling of security and relieves the individual from care and worry concerning financial status when unable out of one's own earnings to provide for oneself.

Contributes to Philanthropy. Many of our institutions that render highly important social benefits to the community at large are dependent, in whole or in part, for their support upon gifts and contributions. Many of these institutions render a valuable service in providing for the care of individuals who might otherwise be a burden on the state. In building up endowment funds, the importance of large gifts becomes at once apparent. In times of difficulty and uncertainty, those who would in the ordinary course make substantial contributions frequently hesitate to do so. Fear of shrinkage in the assets of an estate that might deprive survivors of the donor of funds they need often has the effect of limiting gifts to philanthropic or charitable institutions. The problem may be solved through the agency of life insurance. The benefactor is thereby enabled to create immediately a fund for the philanthropy which he favors. He pays regularly out of income to the life insurance company and has the satisfaction of knowing that the amount determined upon will be paid in the event of his death without in any way diminishing the assets of his personal estate.

Affords Vehicle for Pension Plans. Retirement income plans inaugurated by private industrial organizations made their appearance about a half-century ago and were designed to improve the morale and stabilize labor turnover by holding out to faithful employees the prospect of security for old age. As a matter of theory there is no reason why any business institution might not set up its own pension plan and administer the fund itself. As a matter of actual practice, many difficulties have been encountered. Privately administered pension plans have in many instances been wrecked by unsound management. Considerable dissatisfaction has resulted because of the uncertainty of employees concerning the status of their pensions. It was a natural consequence to turn the entire problem over to life insurance companies. These companies had the equipment for investment as well as the statistical information to determine payments adequate to meet future problems, and it is now regarded as good business to turn the administration of such a highly technical project as a pension fund over to an organization trained and equipped to handle this type of business. The life insurance busi-

ness now affords a sound basis for individual pensions when the institutions or industries planning them wish to augment the Social Security programs of their employees through the establishment of a special fund for the purpose.

FOR REVIEW

1. Mr. F. N. Belgrano, President of the Pacific National Fire Insurance Company, in an address before the sixty-fifth annual meeting of the Fire Underwriters Association of the Pacific, stated: "If there were no insurance companies to pool losses and spread the cost over a wide field, business men and manufacturers, in order to build up and maintain the reserves necessary for adequate self-insurance, would be compelled to charge many times the low prices the public pays today for necessities and luxuries alike. Only a few could afford to buy more than the barest necessities of life and our standard of living would drop to the level of other nations." Do you agree? Justify your statements.
2. From an economic standpoint, in addition to providing protection to insureds, what other service has insurance rendered?
3. It has been the history of life insurance in this country that reserves have continued to grow. Even in the three years of depression, 1932, 1933, and 1934, the total income of life insurance companies was two and one-half billions greater than their total expenditures, and their total assets grew by that amount while the assets of other formal savings institutions were being drawn off and reduced. Can you give any explanation for the continued growth of life insurance assets?
4. When there was a need to release capital for the construction of new homes and for the repair and renovation of deteriorating properties Congress enacted a National Housing Act and thereby created the Federal Housing Administration. Explain how the objective was obtained through the agency of an insured loan.
5. It is contended that the Social Security program of the federal government is far-reaching in its consequences, but that life insurance voluntarily purchased affects only a small proportion of the people of the country; and those it does affect are those who earn comfortable incomes during their lifetimes. On the other hand, it is stated that "millions of families regard their life insurance policies as their principal protection in the case of the death of the breadwinner." In your opinion, is the social significance of life insurance limited or very broad?
6. Insurance is said to have been an important factor in establishing the land values in our western states during the period of pioneering. Can you explain this statement?

Chapter IV

ECONOMIC INFLUENCES

Productive Aspect of Insurance. In the field of economics, insurance finds a place under the general heading "production." It has already been noted that risk has an inhibiting effect upon business activity. The drive for security prompts caution, and it was not until some method was devised for minimizing the effect of risk that funds were encouraged to flow into the vast business enterprises that now characterize our economic structure. A distinguished insurance authority, after pointing out that the United States leads the world in the amount of insurance sold, proposes the question, "But what does insurance mean?" and then answers the question thus:

> Perhaps the best way to answer is to consider what would happen if insurance did not exist. Few but the most gigantic enterprises could operate at all in the absence of insurance, and without it such activities as exporting would be almost impossible. The institution of insurance enables entrepreneurs of industry and agriculture to delegate to specialists the assuming of the risks thus permitting the entrepreneurs to devote their energies to the activities of production proper. Insurance is the most highly-developed means by which business may safeguard itself from hazards. The more extensively and intensively insurance is developed, the more it is possible for entrepreneurs to concentrate on production management.[1]

It is at once apparent that only the enormously wealthy institutions that could afford great losses would venture their capital in the undertakings necessary to carry on everyday affairs. As a matter of fact, there is grave question as to whether many, if any at all, of our great business institutions could reach the size where they could afford to do without insurance, without insurance itself to help them grow. Certainly, today, investors in all leading enterprises would be reluctant to permit the use of their funds in the form of loans or equities if they felt there was a possibility that their investments would be wiped out in a single catastrophe such as a fire, earthquake, tornado, or the like.

The willingness to assume risk, it has been stated, is fundamental

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[1] Manes, A., "Insurable Hazards," *Journal of Business of the University of Chicago*, Vol. XIV, No. 1, p. 1.

in a free economy.[2] When individual business enterprise seeks profit in its ventures, risk and uncertainty are the inevitable concomitants. The opportunity to enter upon a business venture with profits as the objective is inseparably associated with the risk of incurring losses. By means of insurance the burden of risk is transferred to a carrier willing to assume it. Its economic significance has been summed up thus:

> . . . . Protection against the risks of death, accident, sickness, fire, storm, shipwreck and other acts of God not only is consistent with economic freedom but actually promotes it.
>
> By being able through insurance to eliminate these and other fortuitous risks, men can concentrate their energies and capital upon the creative work of the world. To illustrate it simply, if a small businessman can make provision for his family through life insurance, he is then enabled to risk his small savings in expanding his business. Without insurance he would probably feel compelled to invest his small savings at the going rate of interest in something having a minimum of risk, or to hoard them. Again, if it were not for fire insurance many businesses, the victims of fire loss, would be ruined financially and thus would be unable to make their individual contributions to an expanding economy.
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> Both in origin and in operation the principle of insurance is both compatible with and promotive of the objectives of a free enterprise economy.[3]

Insurance has come to be an essential part of virtually every business enterprise. For example, among other essentials, investment bankers ascertain in connection with their appraisal of an investment offering that every reasonable insurable risk is protected by adequate insurance. This practice is so universal that the purchaser of a bond secured by a mortgage would hardly think to inquire of the banker whether the property securing the bond were or were not covered by insurance. A group of men entering upon a manufacturing project would hardly think of building a factory or investing large sums in raw material in process without first protecting themselves by insurance. As a matter of fact, before grounds were actually broken for the factory, insurance would be negotiated to provide for day-to-day protection as work progressed. Ships are sent to the far corners of the earth to bring raw materials, as well as manufactured goods, from abroad. The huge sums invested in bottoms, as well as the risks involved in the value of the cargoes, make the transportation of great

[2] Berge, W., Address before Twenty-second Annual New England Insurance Agents Convention, Poland Springs, Maine, *The Standard*, Vol. CXXXIX, No. 1, p. 17.

[3] *Ibid.*, p. 18.

values a simple business transaction when the risk of loss from the perils of the sea has been transferred by means of a small paper contract, known as the policy of insurance. The list could be carried interminably. The number of policy forms designed to meet business risks is long, and the list continues to grow as the needs present themselves. So many and so complete are the different forms of cover that the economic problems growing out of the element of pure risk are almost a matter of no concern to the entrepreneur other than to call his insurance broker or agent and ask him to provide insurance protection adequate to the risk. The business of providing protection has thus become an economic institution. Giving emphasis to its economic significance, it has thus been defined:

> Insurance might properly be viewed as an approved mechanism for minimizing the fortuitous risks of life so that man's energies will be more free to assume other risks in adventurous grappling with those problems which he has a chance to solve. If we did not have insurance we probably would not be able to maintain a private competitive system. Individuals would hardly be able under modern conditions to risk their capital on new business ventures if they were not able to pool with others through insurance their risks of accident and disaster. Consequently, it should be emphasized that insurance is a system of calculated risk, and as such it is a constructive corollary to enterprise. Insurance is not designed to displace enterprise, but to assist it.[4]

To eliminate risk entirely as it attaches to the individual could only mean a controlled economy. This would eliminate many ventures undertaken with the hope of a wide margin of profit. It is insurance that makes these ventures possible. Without insurance our economic structure as presently constructed would collapse.

Effect of Evolution of Economic Society. The last half of the eighteenth century witnessed the transition from the handicraft to the factory system in England. The social change that was effected from 1770 to 1840 is referred to by economists as the Industrial Revolution. The period was marked by an acceleration in the progress of invention. Around the improvement of the steam engine the iron industry developed, and as an outgrowth of this we entered upon that phase of industrial life sometimes referred to as the "Age of Machinery."

During this period there was set in motion a series of changes in the economic and social structure that affected the position of the

[4] *Ibid.*, p. 18.

individual and tended to destroy the security provided by the older, and passing, institutions. As part of the process of evolution of society the guilds gradually became less and less important until eventually they all passed away. It was during this period that production passed from the handicraft stage to the factory system.

With the development of factories, workmen began to congregate in cities and work for a weekly or daily wage in factories. Laborers no longer owned the material upon which they worked or the tools which they used. Only in rare instances did the laborer perform all the operations on a product. The outcome of all this was the development of two classes. The majority of the people became wage earners; those who owned the factories, tools, and material were the capitalists.

The invention of labor saving devices has resulted in raising the standard of living. Comforts and conveniences of previous generations became the commonplace of the next. The new business structure as well as the changed position of the individual in society subjected him to a myriad of perils which heretofore had been nonexistent. In this changed atmosphere of business, insurance moved away from the family and local group plan of mutual assistance to establish itself as one of the great financial institutions that make up our business structure.

The Mutual and Nonmutual Plans. Insurance as we have noticed it up to this point constitutes a shifting of the burden of the risk from an individual to a group. The group members who make good the loss of individuals are likewise protected in the event that they suffer loss. In other words, the insureds and the insurers are identical. If the losses that the entire group experiences involve a large amount, then the contribution of each member is correspondingly large. If the losses are small, then the contributions are small, and if there are no losses there are no contributions. Under this plan the individual subject to risk exchanges the chance of a large uncertain loss for a small loss that is still uncertain.

Insurance early attracted the capitalists as a profitable source of business enterprise. Individuals, or a group of individuals, frequently agreed by contract to reimburse the person subject to a peril if he suffered loss in return for a premium predetermined when the contract was made. The individual insured had no interest in the capital out of which his losses were to be paid; nor was his charge for

insurance influenced by the size or frequency of the losses which the insurer was obliged to adjust. The group element remained in that the premium contributions to the insurance fund reimbursed the fund for loss payments. To the extent that it failed to do this, the insurer lost money. To the extent that premiums were in excess of losses, the enterprise was profitable. The insurers under this plan were known as individual underwriters.

At the turn of the nineteenth century, with the changing character of industry and with the increasingly large amounts of capital invested in enterprises whose activities extended far beyond the limits of a local community, individual enterprise and partnerships were rapidly replaced by the corporation. Corporations grew rapidly in size and importance to the end that the personal relationship, between the owner of the capital and wage earners, gradually tended to disappear. With this changing industrial control and with the advent of great corporations it was not illogical that corporations should develop to meet the broader needs in the field of risk bearing. This is precisely what happened.

With the business and industrial development early in the nineteenth century, corporations were organized to enter into the business of insurance as a profit making venture. Capital was subscribed by stockholders, and the corporations were organized for the sole purpose of making a profit by writing policies. The capital stock company differs from the group making mutual contribution in that stockholders of a corporation set up a fund for the payment of losses covered by contracts entered into with insureds. Under the capital stock form of insurance protection, the funds that are ready to meet a loss are owned by the stockholders of the corporation, and the insureds have no ownership interest in it of any sort. When the insured enters into a contract for insurance protection he pays the stock company a premium, which is the consideration for the protection. As in the case of the individual underwriters, already noticed, if the losses are in excess of the premium income of the company, the excess must be paid out of the capital owned by the stockholders. If the losses are less than the premium income, after the cost of doing business is covered, the balance goes to the stockholders in the form of a profit.

The two types of business have come down to modern insurance practice. The mutual form operates when the insureds and the in-

surers constitute an identical group or, expressed differently, when the insureds own the capital out of which losses are to be paid. When the fund out of which the losses are to be paid is owned by a group other than the insureds, the form is nonmutual. The mutual form undertakes to provide insurance at cost, and the cost is uncertain. The nonmutual form undertakes to provide insurance on the basis of a fixed and predetermined premium and contemplates in exchange that the insurance company will earn a profit. It is important to bear in mind this distinction, for impressive arguments are constantly advanced in favor of each form of insurance enterprise.

The Insurance Equation. There is no great mystery about the conduct of the insurance business. It is sometimes not quite clear to the layman how any organization can assume a large risk for a comparatively small premium and, when called upon, make payment immediately after commitment. For example, every life insurance company pays huge sums of money for policies issued and in force for less than a year. Insurance of buildings calls for the payment of thousands of dollars in indemnity in return for the payment of what amounts to a few dollars in premium, and so it goes throughout the other branches of insurance. Whatever mystery appears to attach to the ability to pay such claims is at once clarified when it is understood that insurance companies deal primarily with groups. In the case of life insurance, the insurance company is not concerned with when one insured or another will die, but it is vitally concerned with how many will die each year out of a large group. Knowing this, within reasonable limits, the life insurance company adjusts its premium charges so that it will take in enough money to be able to carry on the business and to pay all claims. In the case of other forms of insurance, the procedure is the same. For example, in the case of fire insurance on buildings, the insurance company is interested not in whether specific buildings will burn, but what will be the loss ratio when a large group of buildings is considered. This equality between the receipts in the form of premiums and what is paid out in losses constitutes what may be termed the insurance equation. Certainly an insurance company cannot remain solvent unless it takes in enough funds in the form of premiums to meet all losses. In insurance, as in other business transactions, it is impossible to get something for nothing.

In addition to securing sufficient funds in the form of premium

payments to meet all losses, insurance companies must collect money enough to carry on the business. There are expenses such as rental of buildings, payment of salaries, cost of supplies, taxes, agents' commissions, and the like—all of which form a part of the cost of doing business and must ultimately find a place in the premium paid by the policyholder. Certain of the insurance companies provide special services in engineering, rate making, conducting tests and inspections designed to save property and, by the same token, to reduce premium charges. The companies that support these engineering and research projects must absorb their cost as part of the cost of carrying on the business.

While the insurance premium, in the long run, must pay the cost of all losses and also the cost of doing business, if the premium is to be a fixed sum and at the same time the insured is to be guaranteed an indemnity without any further payment to the company, there must be some source to take care of any deficiency that may develop as a result of a series of losses beyond the expectation of the rate making agency. The fund out of which these losses are to be paid may be put up by the stockholders of an insurance company. Such a fund will in no way belong to the policyholders of the company but will be a guarantee that all losses will be paid. Stockholders who invest funds in an insurance project do so for a profit, and accordingly in the computation of the premium some provision must be made to compensate the owner of the capital invested in the enterprise. If there is no capital invested in the enterprise and the insurance company has the right to call upon the policyholders for an additional payment into the insurance fund (if this is necessary because of an excess of losses), there will be no necessity for computing a return on invested capital as a part of the premium, since the policyholders themselves supply that capital and pay it in when the need manifests itself. When capital is provided by stockholders who are a group different from the policyholders, we have "capital stock insurance." When the capital is provided by the policyholders, and payments are made as needed in the form of an assessment, we have "mutual insurance."

In addition to the foregoing elements that enter into the making up of the premium, conservative companies make an additional charge to set up a reserve for catastrophes. In the computation of premiums, losses are based upon a normal expectation. Insurance

underwriters know, however, that from time to time abnormal situations develop, as, for example, the influenza epidemic of 1918, the various fires that have from time to time destroyed large areas in our important cities, and accidents that have caused the death of a large number of people at one time. Catastrophes of this sort cannot be foreseen, but, because they do happen, preparation must be made for them. It is for this reason that insurance underwriters, particularly the large companies operating on a nation-wide basis, regard a reserve for catastrophes as of paramount importance, and this factor must be taken into consideration in computing the premium. It is notoriously true that small companies operating on a local basis frequently have no such reserve. The company that makes no charge in its premium for a contribution to a catastrophe reserve may be able to cut the costs of insurance to its policyholders and remain solvent, but should it experience a catastrophe of any sort calling for unusual or extraordinary payments, it might be faced with an embarrassing situation.

Summarizing, the foregoing factors that enter into the computation of a premium may be listed as follows: (1) the actuarial cost, or the cost of losses; (2) the cost of doing business; (3) the cost of capital; and (4) the cost of contributions to a reserve for catastrophes.

It will be noticed that the cost of losses and the cost of doing business must of necessity enter into all premium charges. The cost of doing business may vary with different types of companies. A small, local farm fire mutual business may be carried on as a part-time occupation by an attorney, a realtor, or other businessman in the community. He may receive, and often does, a definite annual remuneration for his services without regard to the volume of business that is developed. Other companies may pay an annual remuneration and add to this a commission based upon the business actually written. However, since the costs in such a company are limited to the office expenses and do not involve payments to field representatives in addition, the acquisition cost of business can be reduced to a minimum. In the case of mutual companies there are no stockholders, and accordingly the element of capital remuneration is eliminated. The dividends that in the ordinary course are paid to the stockholders of stock companies do not, as a matter of course, form a part of the premium that is to be collected in the case of a mutual organization. Finally, in both stock and mutual companies,

the problem of building up a reserve for catastrophes must be given consideration when the premium is computed; if no reserve is built up, this cost, of course, will not find its way into the premium charge. It is apparent, therefore, that there is a direct relationship between the carrier organization and the premium necessary for carrying the risk. In the final analysis, however, all insurance companies must collect, in premium income, sufficient funds to pay losses and cost of carrying on the business.

Insurance Involves Groups. From what has already been said it is apparent that insurance is essentially a group undertaking. If there is some accidental hazard that is a constant threat of loss to the individual and if, on the basis of experience, it is found that in the long run a hazard is the occasion of loss to a relatively few individuals in a large group, each member of the group may contribute a proportionate part of all the losses and thereby shift the burden of a serious hazard to himself in such a manner that it is distributed lightly among all those members of the group subject to the hazard.

Reduces Cost. In order to attract capital to a hazardous enterprise, it is well recognized that the greater the risk the greater must be the return. This principle manifests itself in the field of investment. Government bonds, in which the risk is, in general, reduced to a minimum, afford a lower yield than do the bonds of an industrial concern, where the risk is considerable.

So in business enterprises, were it not possible to shift or distribute the burden of risk by insurance, those who risked their capital would have to fix their charges with due regard to the risk of the venture. To illustrate, assume that of every one hundred cargoes shipped each year, valued at $10,000 each, one is lost. The loss per cargo amounts to $100, or 1 per cent. Hence, the shipper knows that by paying $100 plus the cost of doing business through the agency of insurance, the risk of loss is eliminated. Without insurance, even though only one cargo is lost, the risk of total loss attaches to each. In order to attract capital to such a venture there would have to be the promise of a profit far in excess of the insurance premium. When the goods were sold, in the first instance, the insurance charge would go into the price; and in the second, the extra profit to compensate for risk. Hence, it can readily be seen that minimizing the risk tends to reduce costs.

Increases Business Efficiency. As an outgrowth of the proposi-

tion that the reduction of risk reduces cost, it may be stated further that as enterprises become more attractive as outlets for capital, through the minimizing of risks, competition in that particular field tends to develop. With the advent of increasing amounts of capital, increasing efficiency becomes necessary to survival, since competition will reduce prices to a point where the less efficient producers are forced to retire from the field.

Stabilizer of Organization. Business organizations now recognize the value of insurance as a factor in creating goodwill between employer and employee. Corporations, including some of the largest in the country, have provided group policies for their employees, the corporations paying all or part of the premium. These policies are so written as to emphasize the value to the employee of long, uninterrupted service. Again, institutions have availed themselves of annuities and retirement income plans in order to assure a regular income, when the capacity for active service is ended, to those officers and employees who participate.

Again, the insurance of partners in a business to provide the estate of a deceased partner with the amount due it has enabled many businesses, that might otherwise have been obliged to liquidate, to maintain an uninterrupted existence.

Makes Cost of Accidents Certain. Assuming that a business enterprise is sufficiently strong to meet all losses out of its own resources, it is essential in computing costs for future delivery to know within very narrow limits what the losses from accidents will be. For example, a contractor who contemplates bidding on a big construction job knows that there will be a certain number of minor accidents, and possibly some of major importance. If a contractor added the cost of a probable disastrous accident to every bid, he probably would be without jobs. On the other hand, failure to plan for such occurrences might mean a most serious loss. This problem is entirely eliminated by means of the proper insurances, and a fixed charge for accidents in the form of insurance costs can be definitely computed and figured in the bids.

Likewise, a manufacturer or merchant might have a most successful year from operations, yet the cost of accidents might leave the net result of the operations a very substantial loss. Wide fluctuations in yearly profits caused by losses from accidents are entirely eliminated by definitely fixing the cost of loss through insurance.

In ordinary competitive enterprises, unusual losses could not be added to the cost of the goods and passed to the consumer, since business would naturally flow to those competitors whose prices remained unchanged. But even in an enterprise of a monopolistic nature, unless the demand were extremely inelastic, a sudden increase in price to absorb the expense of unforeseen accidents would mean a falling off in demand, a disruption in production schedules, with an attendant loss over and above that which the mark-up was designed to offset. By smoothing out the peaks and valleys of accident cost in the various industrial undertakings and enabling the producer definitely to compute this element in his cost estimates, insurance tends to stabilize earning. Aside from other advantages, this soundness reflects itself in security values, affording a degree of stability where otherwise there might be chaotic fluctuations.

Utilizes Marginal Units of Capital. The question is sometimes asked: "Why, if risk increases costs, can capital be attracted to risk bearing at a rate of remuneration that permits insurance to lessen cost?" There are two answers. The first is found in the fact that through grouping risks and applying the mathematical theory of probability, uncertainty is to a great degree eliminated. Therefore, while there is great uncertainty so far as any individual risk is concerned, when the group is considered, the uncertainty for working purposes is eliminated. The second answer to the question is found in the operation of the theory of marginal utility. Economists recognize that within a given period succeeding units of a good have a diminishing utility to the owner. This utility, as a psychological factor, is attributed by our mental processes to the object, but finds existence only in the mind. The classic example of marginal utility has to do with the consumption of water. If an individual, tired and exhausted, is given a single glass of water, it may be the means of saving his life. Its value to him will be very great. But when he has had enough water to drink, additional glasses of water become less and less useful, until he reaches a point where he has no further need of water at all.

So it is with capital. An individual who possesses a unit of capital, say $10,000 and no more, would be less inclined to subject such an amount to risk than would an individual possessed of a million dollars. It may be, however, that the individual with the $10,000 capital is the one interested in a venture and is in search of an in-

surer. Since the man possessed of the million is in a mental attitude to assume the risk for a less reward because he attaches a lesser utility to this particular unit of capital, his mental attitude permits him to become the insurer. Both parties to the transaction benefit.

As a matter of fact, this simple illustration is scarcely indicative of the procedure in the business of insurance, unless found in the occasional contract of an individual underwriter. The stock insurance company accumulates its capital from innumerable sources. Thousands of shares are issued. Purchasers may buy one share or many hundreds of shares, as their inclinations and attitudes permit. Obviously, if each of a group of one hundred individuals purchases one $100 share of stock in an insurance company, the utility of the accumulated sum in the light of its effect upon each will be very much less than the utility of the $10,000 to the individual who has no more. Moreover, as will presently be noted, through the combination of a large number of risks, the uncertainty as it affects the group has been minimized. Hence, the group risk is far less than the total risk that attaches to each individual in the group.

Economic Impact of the Reserve. Commercial insurance is written in the ordinary course with the requirement that the insurance premium be paid in advance. However, from the point of view of the company, the premium is not considered fully earned until the policy has expired. In the case of property insurance, risks are written for a definite term such as one, three, or five years, and an increasing amount of the premium is earned as the term of the policy passes. The unearned premium reserve must be constantly held intact and is, in the ordinary course, sufficient to meet the pro rata proportion of losses that may develop during the unexpired term of the policy and is, in any case, sufficient to reinsure the risk for the unexpired term of the policy in another company. In the case of property insurance, when the policy has expired the insurance company has no further obligation to the insured, assuming of course that there are no losses pending.

In the case of life insurance, the situation differs considerably from that found in property insurance, and because of this difference the reserves in life insurance reach tremendous sums. While there are life insurance policies written for a term that undertake to make a payment in the event that the insured dies during that term and involve the company in no obligation if the insured outlives the term,

most life insurance policies are written to obligate the company to make a payment of the policy ultimately under one set of circumstances or another. In its simplest form, life insurance embodies an agreement between the insurer and the insured in which, broadly stated, the insurer undertakes to pay a stipulated sum upon the death of the person insured or at some designated time to a designated beneficiary. It will be noted here that in contrast to the property insurance policy, which may or may not be called upon to make a payment under its terms, the life insurance policy as ordinarily written calls for an ultimate payment of the face of the policy. The uncertainty concerning payment as it attaches to life insurance is not, in fact, whether or not a payment shall be made, but rather at what time a payment shall be made. Life insurance, therefore, must provide ultimately for the payment of the face of the policy; therefore, life insurance forms a huge savings plan whereby funds, termed "reserves," are accumulated.

All insurance companies invest their reserves, and the investment return forms no inconsiderable item in the income of the companies. In the case of life insurance, policy payments are computed on the basis that the companies will earn a certain designated return on the reserves. Because of the necessity of earning this return in order that the companies will be in a position to meet their contractual obligations in the form of policy contracts, there is a constant and tremendous investment pressure from insurance companies seeking an outlet for their funds.

It has already been noted that one of the social advantages of insurance lies in this accumulation of a vast investment fund. It is not the intention here to intimate that without these insurance accumulations the funds would not be available from some other source for investment. The fact remains, however, that these vast pools seeking an investment outlet are accumulated, and because of their very size the insurance companies are able to make loans that would seriously tax the resources of all but a few of the larger banking institutions. That insurance itself stimulates the accumulation of investment funds is borne out when it is recognized that life insurance takes upwards of 5 per cent of the national income, a large sum of money that might otherwise be spent for consumers' goods and not find its way into savings at all, or, if all or part of it were in fact saved, the funds would find their way into small commitments and would not be ac-

cumulated into the huge investment fund now managed by insurance companies.

In times when we are accustomed to read of the expenditure of scores, and even hundreds of millions, and even scores of billions, figures of themselves tend to become ineffective. The figures in the field of insurance, however, do reach enormous proportions, and the investments of insurance companies reach into virtually every phase of American business activity.

The total admitted assets of all United States legal reserve life insurance companies at the end of 1941 were estimated to be $32,550,000,000, and this fund is constantly growing.[5] Based upon data supplied by the Securities and Exchange Commission, the income and expenditures of twenty-six life insurance companies during the decade from 1929 to 1938 amounted to the truly enormous sum of $42,679,883,000. During this period there was paid to policyholders $23,221,724,000. After all expenditures were met, such as investment expense, commissions and agency expense and all other disbursements in connection with the carrying on of the business, there was added to surplus and reserves the sum of $10,584,982,000.[6] The figures here cited are those of life insurance because life insurance by a wide margin exceeds in amount the investment fund of other types of insurance companies. To the reserve fund of life insurance, however, must be added the investments of property insurance companies whose surplus and reserves are constantly seeking an outlet in the security market. Indicative of the nature of the insurance contribution to the construction of new enterprise, it may be pointed out that the makeup of investment portfolios of these companies has changed considerably over a period of years. While it is a basic principle of insurance investment that the quality of the underlying security always be of the highest caliber, it is likewise true that insurance investments are to a degree directed by the supply of available securities in a particular field. For example, when public utilities were developing, an important part of the needed capital was found in the investments of the insurance companies. The same was true in connection with the development of railroads. Steel plants as

[5] Brigham, E. H., "Investing for Security of Home and Nation," *Proceedings of the Thirty-fifth Annual Convention of the Association of Life Insurance Presidents* (New York, 1941), p. 107.

[6] "Life Insurance—and T.N.E.C.," Business Week Reports to Executives, *Business Week*. March 16, 1940, p. 51.

well as manufacturing establishments of various types have, to a large degree, been financed by insurance investment. Many hundreds of thousands of homes, farms, and small business establishments have been made possible by mortgages on real estate held by insurance companies. Based on the total admitted assets of forty-nine companies, which approximated $29,850,000,000 at the end of 1941, these assets were roughly apportioned as follows:

About ⅓ of this total is held in corporate securities, chiefly bonds secured by first liens on the property of railroads, public utilities and certain industrial enterprises. The relatively small amount of stocks included is composed, for the most part, of guaranteed and preferred stock issues.

More than ¼ is in government bonds, principally domestic obligations of federal, state and local governments.

Nearly ⅛ is in first mortgage real estate loans within a conservative percentage of the property value. Such loans are principally on non-farm real estate.

Less than 1/10 represents loans to policyholders, within the surrender value of their policies.

About 1/16 represents home and branch office property and real estate acquired in satisfaction of debt.

The remainder, about 1/16, represents miscellaneous assets, including cash.[7]

It is to be pointed out that, aside from policy loans which are made to policyholders as a matter of contractual right, and real estate which is held only as incident to the conduct of the business, life insurance holdings consist almost entirely of first mortgages on real estate and high grade and government corporate bonds. Speculative securities find no place in the portfolios of life insurance companies.

Since 1941 greater emphasis has been given to government securities as a source of investment outlet. By the end of 1945, the ratio of government bonds to assets had increased to 40.3 per cent. The proportion of assets invested in corporate securities had decreased from 31.2 per cent at the end of 1941 to 24.6 per cent at the end of 1945.[8] During the same period, bonds of state and local governments and investments in real estate and policy loans have shown substantial, annual decreases. The amounts so realized have been available for investment in federal securities.[9]

Productive Function of the Agent. It has already been noted that

[7] Brigham, *op. cit.*, p. 107.

[8] While the ratio of corporate securities had decreased, the dollar value of such securities increased about $810,000,000 during this period.

[9] Satterfield, D., Jr., "Report of Life Insurance Association of America, New York Meeting, May, 1946," *The Standard*, May 10, 1946, p. 21.

the United States leads the world in the amount of insurance in force. While perhaps not attributable in its entirety to the system of doing business through agents, who in turn are prompted to sell insurance for the remuneration they receive, it is nevertheless true that insurance for the most part must be sold. It has already been noted that there is a tendency to disregard risks to which the individual has become conditioned, and it often requires the services of a trained and competent insurance expert to outline to an individual or to business management the requirements in the way of insurance to forestall possible disaster. In an untold number of cases, following the death of a wage earner when the flow of life insurance benefits begin to manifest themselves, or following a disaster of some sort involving a business institution when insurance payments indemnify the owners of the property that has been destroyed, insureds have had occasion to be thankful for the persistence of the insurance agent in pointing out the need for insurance.

In recent years the American agency system has been the subject of criticism and attack. In the search for lower costs it has been pointed out that agency commissions are one of the important contributing factors to the cost of insurance. It is pointed out that if the purchaser of insurance is allowed to approach the company direct, without the intervention of the insurance agent, the amount of remuneration which the agent receives in the form of commission will ultimately reflect to the buyer of insurance. Insurance today is a highly complicated subject. If there were no insurance agents, individuals as well as business management would have to secure the advice of competent insurance counsel in order that their insurance programs be properly effected. Whether from an agent or from a family attorney, insurance counsel, or other properly qualified person, it has long since been demonstrated that it is impossible to get anything worth while for nothing, and in the long run the remuneration now paid to agents would have to be paid to someone else performing the same function. To the extent that the agent focuses the attention of his prospects upon the risks which face them, and to the extent that he furnishes them an intelligent service in planning their insurance programs, his service is valuable and economically constructive.

Insurance companies have been constantly striving to improve the service that their agents are able to render and have found no satis-

factory substitute for the agent. The agent unquestionably renders a productive service and is entitled to his compensation.

Present Status of the Business. The status of commercial insurance in the United States today is indicative of the vastness of the enterprise. Fire insurance alone is said to touch every home, every trade, and every industry, for upon it to a great degree rests the credit structure of the nation. The accumulated assets of the insurance carriers, ready to make good the losses arising out of disasters, are literally thousands of millions of dollars. Every town, village, and hamlet, as well as every metropolitan center, has as an integral part of its business community its insurance offices, with agents of the insurers fully empowered to commit their companies to the lines offered and to assume the burden of the risks that the individual cannot or will not carry.

The growth of the business of insurance since the turn of the twentieth century has placed it well in the forefront of the important commercial enterprises of the nation. It has successfully survived war, depression, catastrophe, and panic and forms one of the most stable sections of our economic system. The vastness of the institution and its far-reaching importance, a matter of common knowledge to those engaged in the business, is scarcely realized by those who have not troubled themselves to investigate.

In the field of life insurance alone there are approximately 71,000,000 persons who hold one or more policies. This accounts for approximately half the population of the country. At the end of 1945 the aggregate estimate of the total amount of life insurance outstanding in all United States legal reserve companies reached the astronomical figure of approximately $155,000,000,000. The combined assets of the life insurance companies reached $44,750,000,000. It is estimated that $2,500,000,000 has been paid annually over the past five years to policyholders. In 1945 this figure was estimated to reach $2,700,000,000. Of this amount 48 per cent in 1945 was distributed to beneficiaries of deceased policyholders as death claims while the balance of 52 per cent was disbursed to living policyholders as matured endowments, disability benefits, annuities, dividends, and surrender values. The dollar value of death payments in 1945 amounted to approximately $1,300,000,000. The dollar value of disbursements to living policyholders approximated $1,400,000,000.[10]

[10] *Ibid.*, p. 22.

Even with these figures in mind, it is extremely difficult to comprehend the magnitude of private life insurance.[11]

Insurance statistics compiled by the Bureau of the Census from information collected in 1936 and published in 1937 indicate that in the United States there are 4,428 insurance carriers, 8,302 branch offices, and 56,624 agencies. An average of 389,511 persons were employed during 1935, with a pay roll of $677,015,000, of which $9,475,000 was paid to part-time employees. In addition, branch offices reported 78,747 office solicitors receiving $87,190,000 in commissions during 1935.[12]

Indicative of the nature of the employment offered, personnel of branch, departmental, and managerial offices is composed principally of office solicitors and direct selling employees, and the next most important occupational group includes office and clerical employees. In the subsidiary offices, executives and clerical employees are far less numerous than in carrier home offices. In insurance agencies and brokerage offices, office and clerical employees are more numerous than any other occupational group. In this field there are 55,070 active proprietors, many of whom report no employment and others who operate one-man establishments except for the services of a single clerical employee.[13] In the home offices, clerical employees comprise more than seventy per cent of the total number of employees and executives and salaried corporation officers represent 6.9 per cent. Home offices include, in addition to the executive group and office and clerical employees, physicians, engineers, accountants, attorneys, mathematicians, real estate and investment experts, economists, statisticians, and other highly trained experts in specialized lines.

The *Sixteenth U.S. Census* indicates insurance to be the principal occupation of 524,723 persons. Of this group, 283,600, representing over half the number, were agents or brokers. According to computations made by the National Association of Insurance Agents, the

[11] To secure a complete picture of life insurance coverage in the United States, it should be remembered that there is approximately $8,000,000,000 fraternal and assessment insurance in force, and the government's national service life insurance reached before the end of 1945 a figure of $135,000,000,000. The amount of coverage under the Social Security Act is constantly increasing, and the life insurance value of the old age and survivors benefits is estimated to be $67,000,000,000. The total, therefore, of private and public life insurance in force at the end of 1935 represents a sum considerably in excess of $350,000,000,000.

[12] United States Department of Commerce, "Insurance," *Census of Business: 1935* (Washington, D.C., 1937), p. vii.

[13] *Ibid.*, pp. vii, xiii, xv.

figure represents slightly more than one out of every one hundred persons gainfully employed in 1940, and approximately the same number as engaged in such industries as coal mining, utilities, printing and publishing, automobile manufacturing, or the hotel business. On the basis that 3.6 persons constitute the average household of each gainfully employed person, the number of persons deriving their living from insurance reaches the impressive figure of 1,909,000.[14]

In the field, aside from agents and brokers and their employees who make direct contact with insureds in producing business, there are company field representatives, general and special agents, and adjusters. Specialized groups include chemists, electricians, and en-

TABLE 1

CARRIERS—HOME OFFICES*

KIND OF INSURANCE	NO. OF OFFICES	PER CENT OF TOTAL	AVERAGE NO. OF EMPLOYEES	PER CENT OF TOTAL	TOTAL PAY ROLL (ADD 000)	PER CENT OF TOTAL
United States total	4,428	100.0	159,314	100.0	$268,770	100.0
Life	1,209†	27.3	93,514	58.7	153,014	56.9
Fire and marine	2,620‡	59.2	27,150	17.0	50,388	18.8
Casualty, surety, and miscellaneous	599	13.5	38,650	24.3	65,368	24.3

* From United States Department of Commerce, "Insurance," *Census of Business· 1935*, (Washington, D.C., 1937), p. ix.

† Includes a number of fraternal orders reporting little or no employment.

‡ Includes a number of local farm and county mutuals reporting little or no employment.

gineers who test material and devices used in the construction and protection of buildings. Aside from the number gainfully employed at full-time occupations, thousands are employed part time. In this category are to be found local physicians who make examinations for life companies, attorneys who assist in difficult or litigated adjustments, independent adjusters, and credit investigators.

Table 1, based on information collected in 1936, shows the employee and pay roll distribution for carriers classified according to kind of insurance. The *Census of Business,* published in 1937, indicates that there are sections of the country in which a large number

[14] From a study made by the National Association of Insurance Agents entitled "Insurance Is an Important Business in the Economic Life of the Nation," summarized in *Fire Insurance Facts and Trends* (National Board of Fire Underwriters, April, 1945), p. 2.

of insurance company home offices are located. These are frequently referred to as insurance centers. Particularly to be noted are the states of New York, New Jersey, and Connecticut. Commenting on the geographic concentration of insurance, the same *Census of Business* states:

The home offices of 1,917, or 43%, of all carriers, are located within six States—Illinois, New York, Pennsylvania, Wisconsin, Ohio, and Texas. Home offices in these same six States likewise represent 48% of all home office employees (average for the year). It is significant to note, however, that the home offices of carriers domiciled in New York, while representing only 9.7% of the total number of offices, account for 28.4% of all home office employment. This is in contrast to the situation in Illinois, where 9.8% of the total number of home offices account for only 5.8% of the total number of home office employees. Connecticut and New Jersey compare with New York, in that, although together representing only 126 of the 4,428 home offices, they account for 29,634 of the 159,314 home office employees, an average of 235 employees per office.[15]

After pointing out that few people in the general public realize the enormous proportions to which this business has grown, and the many forms of insecurity against which it is able to provide, Brearley states:

At the present time, whole sections of the larger cities are given over to the business of insurance, and from these sections there stretch out invisible lines, which virtually tie together the entire population and the total property values of the country in a network of systematic, scientific cooperation, which has come to be one of the most important social factors of modern life. Thus, the Age of Insurance as a title is as much justified for the present time as is any other designation.[16]

To such a point has insurance developed as an economic institution that in 1944 the Supreme Court said of it:

The modern insurance business holds a commanding position in the trade and commerce of our nation. Built upon the sale of contracts of indemnity, it has become one of the largest and most important branches of commerce. Its total assets exceed $37,000,000,000, or the approximate equivalent of the value of all farm lands and buildings in the United States. Its annual premium receipts exceed $6,000,000,000, more than the average annual revenue receipts of the United States Government during the last decade. Included in the labor force of insurance are 524,000 experienced workers, almost as many as seek their livings in coal mining or automobile manufacturing. Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as

[15] U.S. Department of Commerce, *op. cit.*, p. ix.

[16] Brearley, H. C., *Banishing Insecurity* (New York: Spectator Co., 1926), p. 58.

does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States.[17]

From a co-operative idea of mutual assistance among neighbors is found the point of departure from which developed a business institution that touches the lives of all of us.

FOR REVIEW

1. Lord Macaulay once said: "The primary end of government is the protection of the person and the property of men." How does life insurance supplement this function of government?
2. Mr. F. C. Oviatt, writing in 1905 in the *Annals of the American Academy of Political and Social Science,* stated: "Life insurance is based upon the value of the individual and the necessity for protecting that value. In its inception, it is individual. It treats with individuals as individuals and also assembles them so that they can be considered as masses of individuals. From this starting point, which is purely social economic, a superstructure has been built up and is still building, which touches the entire life of the community in its social, economic, financial, material, and ethical life." Explain how life insurance, in addition to affecting the individual, touches the community in its social, economic, financial, material, and ethical life.
3. It is stated that criminals are largely the result of environment. What relation has this statement to the social value of life insurance?
4. Hon. Charles Evans Hughes, in an address before the Association of Life Insurance Presidents in 1926, stated: "A reference to the feature of thrift and protection suggests the foundation but does not explain the structure. As the Supreme Court of the United States has pointed out, the object of life insurance is not only protection but investment; that is, the protection is achieved through investment and thus the field of cooperation is widely extended." Explain.
5. It is stated that the wholesome effects of insurance of inducing citizens to assume a post-mortem responsibility for their dependents and to adopt a policy of thrift do not end here. Life insurance unquestionably benefits the persons affected. To what extent does it affect the public?
6. The difference between an insurance contract and a wager has not always been clearly differentiated. When it is stated that insurance is socially beneficial and gambling is socially undesirable, if the distinction between the two contracts is not clearly understood, the statement appears to be a contradiction. Explain this difference.
7. A is a young man who has been educated in an expensive preparatory school, has graduated from college, and is now in the course of completing his first year at medical school. It has been the ambition of himself and his parents that he secure the best medical education obtainable and follow in the footsteps of his father in the medical profession. The sudden death

[17] *United States* v. *South-Eastern Underwriters Association et al.,* 64 Sup. Ct. 1162.

of his father has created a financial crisis in the family which makes necessary the discontinuance of these plans. Why may the disaster be more far-reaching than simply an abandonment of a long-cherished plan, and how could it have been forestalled by life insurance?

8. Insurance is said to be a factor in reducing the possibility of crime. Explain.
9. Entirely aside from the humanitarian aspects of educational and safety methods in industry as promoted by insurance companies, what is their economic significance?
10. One of the economic contributions of insurance is stated to be found in the practice of the business which provides for the study of new hazards with the development of appropriate insurance. Discuss.
11. By making the cost of losses certain, a manufacturer does not have to put in his costs a loading for unknown losses. Thus, insurance tends to reduce consumers prices. Explain another way that insurance contributes to lower prices.
12. It has been said of the business of insurance that it has encouraged "men and corporations to hazard their resources" in productive undertakings to the general welfare of the community. Explain.
13. The protection afforded by insurance has permitted wide extensions of credit that could, in the ordinary course, not otherwise have been made. Indicate the economic significance of this feature of insurance.
14. If, as part of the process of regulation, a state should make rates that to the insurance company seemed unsound, and the insurance companies as a result should decide to withdraw from business in that state, what in your opinion would be the impact on business?
15. It has been stated that in the long run the insureds pay all losses. If this is true, what is the point of insurance?
16. It has been stated that anything that diminishes the degree of uncertainty reduces the cost of risk to society. Explain the economic significance.
17. Insurance is said to belong in that division of economic theory that deals with the phenomena of the production of wealth. Discuss.
18. Willett, in his classic study *The Economic Theory of Risk and Insurance,* states: "To define insurance, then, as the distribution of losses is to make too prominent an indirect and comparatively unimportant result of it, and to leave entirely out of the definition the elements in which its economic significance really lies." Explain the meaning of this statement as it has a bearing upon the economic significance of insurance.

CHAPTER V

INSURANCE AND LOSS PREVENTION

INSURANCE in Its Relationship to Risk. Insurance, it has been noticed, is the shifting of the burden of the risk. Insurance of itself does not eliminate, nor does the payment of an insurance claim in any way alleviate, the net economic loss to the community. If a building valued at a million dollars is destroyed by fire, the fact that the owners of that building are indemnified by insurance does in fact relieve them of a great loss; but the social loss to the community of a value of a million dollars still remains. The fact that the burden of the loss has been shifted by insurance does not eliminate the loss itself. The loss is there. Its burden has been only lightened.

Closely allied with insurance is the problem of protection and loss prevention. It has been sometimes said that the institution of preventive measures is insurance. For example, it has been said that money spent for the construction of dams constitutes flood insurance. This is not technically correct. To the extent that dams control floods they constitute a preventive measure. They are not insurance.

There was a time when a substantial group in the insurance fraternity felt that the prevention of losses and the encouragement of preventive measures was no concern of the insurance business. It was stated that, if the insurance industry collected a premium computed on a rate that was in turn commensurate with the risk, it had served its function. If the owners of property wished to institute protective devices to reduce the loss hazard, that was their prerogative, but it was not the function of insurance to take the initiative. There were those who went even further by pointing out that the installation of protective features on a risk tended to reduce the premium and hence the profit of the insurer.[1] The insurance business soon learned the fallacy of this conclusion. It was found that where every protective feature possible could be installed the loss ratio tended to stabilize itself. Wide fluctuations in losses, ranging even into the

[1] "It may seem strange," says the Research Bureau of the Minneapolis Civic Council, "that a business which seeks insurance premiums should devote its energies to reducing them, but insurance in America is far sighted—it knows that the best road to insurance prosperity is in reducing losses, not increasing premiums" (National Board of Fire Underwriters, *Fire Insurance Facts and Trends* [April, 1945], p. 4).

classification of catastrophes, tended to be eliminated and a reasonable stability introduced into a business that in its early days was shrouded with great uncertainty.[2]

Today the insurance business is one of the most powerful forces stimulating the installation of protective devices having for their purpose the prevention or minimizing of insurable losses. Protection is not insurance, but today it is a reasonable concomitant of the business.

National Board of Fire Underwriters. This organization is maintained by a large group of the leading stock fire insurance companies for public service in the fields of education and fire prevention. Its particular interests center around the questions of building construction, engineering standards, the investigation and suppression of incendiarism and arson, and public education.

The board has developed as a center of fire loss statistics and fire prevention activities. Reports of hundreds of fires daily, with statements of cause, extent of fire damage, and all pertinent facts, are sent to the statistical department for analysis. Over 10,000,000 fire reports have been studied and tabulated in a decade. From this mass of statistical information the board draws its conclusions as to causes of fire and makes corresponding recommendations for prevention.

The Underwriters' Laboratories. The Underwriters' Laboratories is a service organization maintained by stock fire insurance companies through the National Board of Fire Underwriters. This institution maintains a large corps of scientists and specially trained assistants who make tests of a wide variety of products concerned with the cause or prevention of fire.

Among the materials and devices inspected are building materials, electrical fixtures, wiring, household appliances, gasoline pumps, fire alarms, automatic sprinklers, fire-resistant safes and cabinets, fire doors and windows, asbestos products, motion picture machines, films, transformers, X-ray apparatus, cleaning fluids, paints, cements,

[2] For example, according to the National Board of Fire Underwriters, a five year average of fire companies shows an underwriting loss of 0.78 per cent, or $17,191,170. In 1945 there was a 4.3 per cent underwriting loss, while in 1944 the underwriting loss was 2.8 per cent. Underwriters regard a 2 per cent underwriting profit in a year as very satisfactory. To this is added earnings from investments, a substantial part of which are retained by the business in the form of voluntary reserves. With the underwriting margin as close as it is, a business subject to wide loss fluctuations would have difficulty in surviving, or in any case there would be a casualty list of weaker companies that would bring demoralization to the business.

containers for shipping hazardous liquids, and hundreds of other items.

Within the scope of the Underwriters' Laboratories' activities are tests of new products by a group of experts. Radios, refrigerators, oil burners, and the like are tested, as well as all forms of electrical equipment and wiring, roofing materials, and other building materials designed to prevent the spread of fire. After a product is tested, it is either approved or rejected with recommendations for improvement. The tests are thorough and practical, and the attachment of the Underwriters' Laboratories' label of approval indicates that the article has been safely constructed with reference to the fire hazard and is therefore safe and reliable for the purpose designed.

Engineering and Inspection. The loss prevention work of insurance companies is becoming an increasingly important service to policyholders. They are recognizing the relationship between engineering and inspection services and losses and are calling upon the facilities of the insurance company engineering services for their expert advice in protecting plants and equipment. It has been demonstrated over and over again that expert engineering and inspection work go hand in hand with loss reduction.

The engineering services of insurance companies, the outgrowth of their wide experience, are in a position to provide expert advice to insureds who are entering new fields or, because of the development of new materials, are faced with hazards that are unknown in their previous experiences.

Pioneering experiences with new methods, such as the use of plastics, highly inflammable gases, and new types of compounds, frequently bring into focus hazards with which the manufacturer has heretofore had no experience whatever. The increase in the new uses of metals, such as magnesium, poses problems in protection engineering. Then again, air conditioning systems that involve the return of exhaust air back into the buildings in an effort to economize heat, and the introduction of high-speed machinery, create situations which may give rise to disastrous losses.

In the case of large risks, a specialized service is provided which includes a complete and thoroughgoing inspection of the property at stated intervals, together with special inspections whenever changes in the construction, additions to a plant, or other changing conditions make such inspections seem necessary or of value. Water supplies

are tested periodically, and tests are made of valves, sprinkler equipment, hose, and other protection equipment. Special hazards are studied with a view to determining the safest processes.

When new buildings are contemplated, specifications and plans are checked in advance with a view to recommending the installation of the most adequate and approved protective equipment. This last service reflects in substantial dollar returns to the insured, in that it is frequently easy to make a change in a building when it is still in the planning stage that may have the effect of materially reducing the insurance rate, where such a change can be expensive or even impossible once the building has been constructed. Special information is prepared in a booklet form dealing with such subjects as the storage of inflammable liquids, methods for preventing dust explosions in manufacturing plants, methods of determining the destructive effect of wind forces on buildings. Not only have fire losses been prevented through the installation of automatic fire prevention devices, but as well through the encouragement of fire resistive construction. Automatic devices such as sprinkler systems have been installed, fire walls included in the construction, vertical openings enclosed to prevent the spread of fire, and fire extinguishing equipment provided. Developments in industrial fire protection have been carried to such an extent that it is not unusual to pin a small fire within narrow limits so that it can be quickly extinguished, where formerly such a fire would have swept through the entire structure, resulting in the complete destruction of the plant.

The National Board of Fire Underwriters has set up standards for sprinkler equipments and standpipe systems. A basic consideration in such installations is a water supply system of adequate capacity and pressure. Studies have been made with a view of determining the adequacy and reliability of municipal water systems. Fire-flow tests are made during which a number of hydrants are opened and the discharge measured while pressures are observed at closed hydrants located within the group under test. By this means, it is possible to determine what pressures might be expected when a fire is in progress and a number of hydrants opened for the purpose of fighting it. As a result of the tests, recommendations are made to the water company with a view to the installation of necessary improvements that will provide adequate fire fighting service. These tests are carried on with careful regard to the needs of plants in which sprinkler systems are

installed or where their installation is recommended. Recommendations are made for fire protective installations in buildings and in areas that might act as conflagration breeders.

Educational programs have been instituted by fire insurance companies with a view to saving minutes in turning in an alarm when a fire happens. Amateur attempts to put out fires have often resulted in the spreading of the fire to the end that very serious losses have developed that might otherwise have been prevented had professional fire fighters promptly been summoned.[3] As part of the educational program in industrial plants, emphasis is given to the fact that delayed alarms have been a critical factor in many instances contributing heavily both to loss of life and property.

The program of education carried out by the insurance industry undertakes to create a consciousness of the relationship between loss prevention, the stabilization of profits, and the permanency of employment. Insurance companies encourage employee instruction in fire fighting and in how to conduct themselves in other types of emergencies. It has been found that accidents have been minimized and losses curtailed when the employees have been thoroughly instructed with reference to all possible emergencies in advance. Severe losses have resulted when employees in a plant have turned off sprinkler systems in a panic or have blocked automatic fire doors to the extent that they have failed to close as they were intended.

Accident Prevention in Industry. In the field of accident prevention, it has long been one of the goals of the insurance industry to educate employees in every way possible to "save man power." It has been pointed out that entirely aside from the reflection of a good accident experience in a reduction of insurance costs, there is as well an unseen gain, the outgrowth of a reduction in work interruption and a build-up in employee morale.

The insurance business has not only encouraged organized accident prevention and the installation of every conceivable safety device designed to protect the health of the employee, but it has as well provided, through its own staffs of engineers, inspectors who make

[3] The burning of the liner "Normandie" on February 9, 1942, is a classic example of the failure of fire extinguishers and fire hose. After fifteen minutes spent by workmen in attempting to extinguish a pile of kapok life preservers which caught fire from an acetylene torch, the New York Fire Department was called. It is reported that the department arrived ninety seconds later, but the fire was out of control. A fire that could have been extinguished easily in the first five minutes destroyed the ship.

positive recommendations designed to increase safety and eliminate occupational accidents and injuries.

In larger plants insurance companies encourage the establishment of a safety organization with a full-time director and adequate staff. In smaller plants where a full-time director is out of the question they encourage the training of a responsible executive for this position. It is the aim definitely to set up in every manufacturing establishment, whether large or small, a positive program designed to protect the health and welfare of employees.

Inspections are carried on by the insurance companies with a view to inviting attention to any situation that may give rise to an accident, such as old machinery, inadequate guards or substandard equipment. First-aid equipment is invariably recommended and, where the size of the plant will warrant, a medical staff with nurses and equipment for immediate treatment of accidents.

Insureds are advised to have all plans and specifications checked for safety, prior to the commencement of construction. This involves among other things: checking for structural strength, fire protection, adequate exits, and compliance with building and safety codes. A check is recommended in the blueprint stage so that machinery and equipment will be installed in line with the best practices.

Personal selection and training on a scientific basis is encouraged to the end that employees will be selected for work for which they have an aptitude and for which they are physically qualified. This study of employees is not limited solely to the time of placement but a follow-up is advised with a view to determining that each employee is mentally and physically qualified for the work he is doing. In positions involving specific hazards, an adequate period of training under supervision is recommended. Constantly, through the agency of literature, signs, group meetings, conferences with supervisors, and every other conceivable means, the ever present danger of accident is emphasized together with warnings as to how accidents may be avoided.

Building Codes. The fire insurance industry encourages the adoption of building codes designed to provide for fire safety and the prevention of the spread of fire. The National Board of Fire Underwriters in 1905 published its first recommended building code.[4]

[4] Following the Baltimore conflagration of 1904, studies of the conflagration hazards in American cities was intensified. The outgrowth of this work reflected in recom-

Its widespread adoption has unquestionably contributed to public safety and has been an important factor in loss prevention. Since its first publication, numerous revisions have been made with a view to keeping the code current with the findings of safety experts and authorities in the field of fire control.

In a competitive society, buildings constructed with a profit-yield in view tend to be built at a minimum cost. It is self-evident that competition will tend to eliminate non-revenue-producing safety devices. The means left, therefore, for securing them is on a basis of compulsion. This is the reason that building codes have become a necessary part of our legal structure. As expressed by the National Board of Fire Underwriters:

> Stripped of its legal and technical phraseology, a building code is really a set of rules to keep people from getting hurt. Through shortcomings in building construction, a man may get hurt either physically or financially. Physically he may be injured by collapse of the structure, by falling through unguarded openings, by being burned, through sickness resulting from improper sanitation, or from any number of other causes. The same occurrences may cause him financial loss, whether he be owner, occupant or merely a passerby.
>
> Not only does the building code concern itself with individuals, but there are also deeper implications in the regulations, ... To achieve its purpose, a building code must result in reasonable safety to the community, to the occupants of a building and to the building itself.[5]

It is the contention of the board that fire quite definitely is subject to control. Unlike earthquakes and tornadoes, with care, fire may be prevented. The action or inaction of one property owner definitely affects his neighbors. To the end that fire can be prevented and the extent to which its spread may be limited through the adoption of codes, the fire problem is one within the control of legislative action. Relying upon this hypothesis the board has publicized at great length its recommended code. Further than this, through the use of publicity, it has given emphasis to defects in construction and has made recommendations that have been an important factor in preventing the start of fires.[6]

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mendations leading to the improvement of fire fighting facilities such as water supplies, fire departments, as well as alarm systems. A close co-operation exists between the officers of the board and city officials and municipal authorities.

[5] National Board of Fire Underwriters, *Building Codes—Their Scope and Aims* (New York, 1945), p. 4.

[6] For an outstanding discussion of building construction in relation to insurance underwriting and fire prevention see Dominge, C. C., and Lincoln, W. O., *Building Construction Applied to Fire Insurance* (3d ed.; New York: Spectator Co., 1941).

Fire Prevention Activities through Chambers of Commerce. The National Fire Waste Council, composed of a large number of constituent organizations among which are a number of insurance and allied groups, in co-operation with the Chamber of Commerce of the United States has sponsored a constructive and far-reaching fire prevention program.

The National Fire Waste Council was created by the United States Chamber of Commerce with a view to assisting businessmen in the elimination of preventable fire waste. One of its principal functions is to make available specialized and technical assistance necessary to the Chamber of Commerce in carrying on its fire prevention activities. These activities were undertaken as the outgrowth of an invitation extended by the Conference of Governors of the Middle Atlantic States in 1922. The council has become an agency for the dissemination of fire prevention and fire protection knowledge. In the work of this council the insurance industry has afforded its fullest support and is quite definitely interested in its activities.

The fire prevention program recommended to chambers of commerce is far-reaching and unquestionably has been effective. The program involves the focusing of local interests upon the problems of fire prevention. No elaborate plan is contemplated or necessary, but it is emphasized that it should not be a temporary activity but should be carried on as a permanent undertaking on an all-year-round basis. Indicative of the direction to be given to its activities, it is suggested that the most recent engineering survey issued by the National Board of Fire Underwriters for use of the state rating-organization be obtained and this used as a basis for a study of municipal requirements. In this connection studying of the following is advised:

1. Analyze local fire loss record. Use fire department to prepare spot map showing distribution and amount of loss of fires throughout the city, as well as tables and graphs showing cause of fire.
2. Acquaint public with the local fire loss facts and with the fire department, its needs, problems and services.
3. Supply industrial department of local chamber of commerce with fire prevention information and fire loss data for solicitation of new industries.
4. Inquire of National Fire Waste Council as to the types of field service which are available to member organizations.

   NOTE: These services embrace such matters as fire department training, organization of private fire brigades, special educational features for children, community analysis and special inspection services.

5. Organize Fire Prevention Week and Spring Clean-up Week programs well in advance.[7]

The value of the work is unquestionably great. It has been able to demonstrate that fire prevention programs pay dividends.

The National Fire Protection Association. This is a voluntary group of organizations and individuals interested in controlling fire waste. It is a nonprofit technical organization and it serves as a world-wide clearing house for fire control information.[8]

The organization undertakes to provide standards of fire waste control. These standards are prepared by experts in the field and include not only representatives of the fire insurance business but, as well, representatives of the industry affected and officials serving to represent the public interest. The standards of this organization not only have a wide influence upon the prevention of fire loss through the voluntary efforts of industry itself but also form the basis of improved legislation in the field of fire protection.

The educational program of the association is impressive. It publishes a number of specialized books substantial in size and technical in character. Other publications cover almost the entire field from highly technical reports to pamphlets for distribution to school children. The number of copies of its publications issued runs during a year into the millions.[9] Its volume on fire protection is a standard reference in the field, and another volume dealing with national fire codes contains the technical standards of the association. Its field service, established in 1924, is exerting a powerful influence in furthering the work of the association, carrying on a constant war against fire and "envisioning a steady retreat of this common foe."[10]

Municipal Fire Protection. Because insurance companies predicate fire rates first upon the fire protection facilities of the community, the savings in insurance premiums effected by adequate protection

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[7] *Fire Prevention through Chambers of Commerce,* Chamber of Commerce of the United States (Washington, D.C., n.d.), pp. 5–6.

[8] There are approximately 10,500 associated members in the organization. Included in this category are public officials, fire department officers, fire insurance officers, engineers, inspectors, and special agents as well as members of insurance bureaus. Insurance representation accounts for 20 per cent of the membership.

[9] For example, the *Firemen's Magazine,* a monthly publication in the interest of fire departments, is said to have a circulation in excess of 23,000 copies a month.

[10] Bugbee, P., "N.F.P.A. Completes Fifty Years of Achievement," *The Standard,* March 29, 1946, p. 10.

have been a stimulus to continued improvement of municipal fire fighting facilities.

All fires are small when they start, and it is during the first five minutes of any fire that developments may determine whether the fire may be put out with a bucket or whether it may spread to catastrophic proportions.[11] Sometimes municipal authorities have been criticized for sending great turn-outs to fires that prove to be nothing more than a smudge or a small blaze. That they continue to do this, it may be fairly stated, is to a large degree due to the study of insurance organizations and the application of the knowledge they have developed. If adequate fire fighting apparatus arrives at the critical moment and only occasionally is able to prevent the development of a huge fire, the economic soundness of the practice is easily demonstrated.[12]

Study and research is applied to the development of fire fighting apparatus for specialized types of fire. For example, a hazard of increasing significance is to be found in the use of oil-burning motors which cause gasoline fires. Such fires spread rapidly, and the method of fighting them with heavy streams of water, it has been learned, tends only to spread rather than to extinguish the blazing gasoline. New techniques have been developed such as the fog-nozzles which give a fine spray of water.[13] Bursting gasoline tanks, crash airplane fires, and the like give rise to situations that can be properly handled only by fire fighting crews that have been highly trained to meet such emergencies. Information dealing with these and like problems has been worked out for the assistance and guidance of local fire fighting units.

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[11] It is estimated that 60 per cent of our fires do damage amounting to less than $100. On the other hand, 1 per cent of the fires account for in excess of 65 per cent of the total national fire loss.

[12] A test made in Washington, D.C., illustrates the importance of "the first five minutes." Two large buildings, in an area being cleared for parking purposes, were burned down by the authorities and the progress of the fire checked. The buildings were five stories high, built of brick and timber, and in fair condition. The buildings were packed to simulate normal conditions. The torch was applied on the main floor of the building. In ten minutes flames were breaking out at the windows; in twenty minutes floor joists had burned through; and in twenty-eight minutes parts of the walls were collapsing. This fire at its inception could easily have been extinguished; but in the second five minutes firemen could not gain access to the building, and the control of the fire was next to impossible.

[13] The Committee on Fire Prevention and Engineering Standards of the National Board of Fire Underwriters has issued a series of bulletins on "Controlling of Flamable Liquid Fires."

Salvage. Quite justly, fire departments have long realized that their primary objective is to extinguish the fire. Unquestionably, however, enthusiasm has sometimes run beyond reason, to the end that a very substantial amount of the fire waste in the country was attributed to the operation of the fire departments. Modern fire fighting undertakes immediately to extinguish the fire without losing sight of the fact that it is also of paramount importance to accomplish the end with a minimum of incidental losses.

The modern trend in municipal fire departments has resulted in the establishment of a salvage corps. Salvage operations have for many years been carried on in the larger centers by insurance companies. For municipal fire departments the idea is comparatively new. Here, again, the National Board of Fire Underwriters is cooperating, and the work is endorsed by the National Fire Protection Association.

It is the function of the salvage corps to appear immediately at the scene of the fire and take any action possible to protect the contents of the burning building from injury, and also, immediately following the fire, to take such steps as may be possible to protect the property from further loss. The salvage corps usually has a completely equipped vehicle and carries, among other things, a large number of rubber or canvas covers which it uses to protect merchandise, machinery, and other contents from water damage. The salvage corps, upon arriving at the scene of the fire, enters the building and immediately starts covering all damageable property below the areas where water is to be used. The officer in charge of the corps is highly trained. He must carry on his work with utmost speed, and he must be in a position to estimate the amount of water necessary to extinguish the fire and predicate his plan of action upon his estimate of the situation. It may be necessary for him to group the contents of the building before it is covered and to locate immediately any openings through which the first flow of water into the area may be expected. In residential property, rugs are rolled up and either carried to a place of safety or protected with other articles of furniture. Steps are taken to protect pictures, lamps, bric-a-brac, and other fragile articles. In industrial and commercial risks a swift estimate of the situation and the speedy regrouping of stock, can, in a matter of minutes, result in the savings of tens of thousands of dollars. The salvage officer will recognize in many instances that the entire stock

cannot be protected before water reaches it, and he must work progressively with a view to saving maximum values and placing the protection where the first water may be expected to evidence itself.

The removal of water from buildings following a fire is another function of the salvage corps. Large quantities of water may accumulate in the upper stories of a building, and its proper handling may reduce insurance claims by very large sums. Through the judicious use of elevator shafts, holes cut in ceilings coupled with chutes to the outside of the building, and the use of stairways, water may be drained promptly from a building and the walls and floors dried and thereby saved from damage caused by warping and twisting.

Basement drainage is another problem handled by salvage men. Unless proper steps are taken when heavy streams of water are poured into the upper stories of a building, the water may accumulate in the basement and do great damage to stock, machinery, and the like. The careful salvage man not only interests himself in the basement of the building in which the fire is raging but will check all adjoining basements, because frequently the water spreads in the immediate vicinity, with consequent water damage attributable to exposure to the fire. It is not always an easy matter to see that a basement is drained immediately or during the period of the fire; but much loss is prevented by seeing that floor drains are unobstructed and, if water is flooding the basements, providing for the immediate removal of the stock to a place of safety. In some instances, siphons are used as a means for draining basements. If the drainage is entirely out of operation, damage may be minimized by directing roof drains outside the building and breaking plumbing fixtures at the floor level to provide further outlets. Salvage crews always check for the possible damage that may result in water coming in contact with electrical equipment. Electricity is shut off wherever there is a possibility of danger. To indicate the extent of the operations of a salvage corps, there follows a list of the drills and instructions arranged for such an organization operated by the National Board of Fire Underwriters:

1. Proper methods of making catch-alls. How to be governed in whether or not such a procedure is necessary.
2. Covering goods on counters, tables, etc., method of rolling edges to prevent water running under covers when more than one cover is necesary to complete the work. Importance of clean covers. How to cover delicate fabrics

and materials easily soiled. Prevention of water damages to bottom of dresses and racks or other materials close to the floor when sweeping water.

3. Drill in covering shelves. Pulling stock from walls to prevent damage caused by water following the wall. Care to prevent injuries to men performing shelf work. Method of catching water following vertical pipe openings.
4. Drill in covering large stocks in piles. Proper laps to make arrangement of pitch. Arrange stock to be covered using the least number of covers possible to perform proper coverage. Explain the difference in the width and length of covers and how to use to the best advantage. How to open the cover to spread in the width or length.
5. How to cover belt driven machinery. Importance of covering elevator machinery in the basements, when sweeping water down elevator shafts. Methods of draining water from basements.
6. Care of plumbing and boilers in freezing weather when impossible to heat building partially destroyed by fire. Care of fruits and vegetables and other stock susceptible to freezing.
7. Instruction and drill in covering household furniture. Handling of rugs, pictures, drapes, curtains, clothing in closets and other hangings. Proper method of bunching furniture before covering.
8. Care of covers at fires:
   1. Throwing covers from windows, down elevator shafts, etc.
   2. Spreading catch-alls over glass or other debris and walking on covers unnecessarily.
   3. Using grommets when nailing stock covers.
   4. Bailing catch-alls with wood scoops to prevent tears.
   5. Spreading covers under dropping fire or in places where they may be burned.
9. Building chutes: Improvised and standard equipment. When and how to use.
10. Opening doors: Methods used on different types of doors. Importance of opening doors efficiently with small damage. Instruction in opening elevator doors and window shutters.
11. How to run house elevators.
12. Covering roofs: Flat roofs, gable roofs and skylights. Instruction in raising roofing material, manner of fastening covers and properly pitching to drain.
13. Care and use of flood lights.
14. Sprinkler instructions: Drill in using tongs, replacing heads, shutting off and draining. Special instructions in wet and dry systems, supervision, source of water supplies and care and maintenance.
15. Cutting holes in floors: Proper methods. When necessary and where to cut. How to handle an axe and care of an axe.
16. First aid.

Bandaging	Stretcher
Splints	Artificial respiration
Tourniquet	Fireman's carry and rescue work
Burns	

17. Care of covers in quarters. Drill in patching and mending rubber and canvas. Instructions in washing, drying and general care to prevent deterioration.
18. Use of different types of portable fire extinguishers. Instructions in their maintenance.
19. Use of inside standpipe lines.
20. Fire box drill on patrol code.
21. Automatic fire alarm systems. How they operate.
22. Parade drill.
23. House watch duties.
24. Fire watch instructions.
25. House discipline and courtesy.
26. Roll call and inspection.
27. Fire department knots.
28. Handling of streams.
29. Raising of ladders.[14]

Prevention of Hurricane Damage. Hurricanes, unlike fires, may not be prevented. Through research it has been possible, to a large degree, to reduce the damage they cause.

Hurricanes affect the South Atlantic and Gulf states and, upon occasion, reach as far north as the New England states. They cover an area often as great as two or three hundred miles in diameter, and they are capable of terrific destruction.

Studies made of wind effects on buildings, especially through wind tunnel tests, have brought to light a body of knowledge that has been of incalculable value. Characteristics of wind damage have been studied to the end that recommendations are available touching upon the best methods, not only of construction to resist wind damage, but also of protecting occupants from injury.

The National Board of Fire Underwriters provides, in the form of a supplement to its recommended building code, special requirements for hurricane resisting construction. Insurance rating and inspection bureaus are prepared to co-operate with water departments to the end that supplies may be continued without interruption. Along water fronts, sea walls are frequently recommended. Educational material is available providing information for the protection of occupants of buildings. The possibility of termite damage is investigated to guard against weakened buildings. Recommendations to be followed, both before the receipt of hurricane warnings and as

[14] McAuliffe, F. C., *Salvage* (New York: National Board of Fire Underwriters, 1942), pp. 39–41.

specific directions once the warning has been received, have been made available. Research made with reference to hurricane damage provides equally useful information for the protection of life and property in other areas where windstorms are prevalent.

Termites as a Hazard. In certain areas of the country termites damage woodwork of buildings, furniture, books, and other articles constructed of materials of plant origin.

The termite problem, contrary to some opinion, does not involve a fire problem due to the possibility of building collapse, though a weakened building may create a hazard where there is a possibility of windstorm damage. The use of fire or inflammable liquids, however, in the process of exterminating termites has developed a fire hazard. Termites, in destroying cotton-covered fire hose, have made ineffective fire fighting equipment. In termite control, if there is substituted the use of poison dust for inflammable liquid, there is a grave possibility of personal injury. Following recommended precautions, danger from these sources is eliminated or at least minimized.

The second phase of termite precaution extends to the recommendation of effective methods of prevention in connection with new construction. This involves such practices as treating wood near the earth with preservatives such as creosote, zinc, chloride, or other effective toxic poisons. It is recommended, in areas where termites are prevalent, that materials such as metal termite-shields, the proper use of concrete, masonry, treated wood, and the like, essential to termite control be made a part of the local building code.

Specialized Research. Innumerable studies in special fields have been made with the view to preserving property, preventing accidents, and saving lives.

Far-reaching studies of school fire records have brought to light the important structural features that have a bearing on fire prevention and protection. While it has been found that fire resistive construction is of great value in reducing loss, it does not of itself provide safety for the occupants. Where great loss of life is involved in schoolhouse fires, panic has been a factor. Modern schoolhouse construction calls for a design that will permit any fire that starts, to be confined long enough to allow the building to be emptied in an orderly manner. Studies are made of every conceivable hazard with the view to its elimination, and special emphasis is given to the

provision of adequate emergency exits so that the building may be emptied promptly under all circumstances.

Similar research has been applied to hotels. Hazards such as the storage of fuel, power plants, ventilation, workshops, storerooms, linen rooms, laundry, and the like all receive special study. Recommendations are made for a type of construction designed to prevent the rapid spread of fire. Automatic sprinkler protection is advised for nonfireproof buildings. For the safety of occupants, two routes of escape are required from every part of the building. Fire resistive enclosures are recommended to protect stairways, shafts, and other floor openings. Large floor areas necessitate fire walls and adequate emergency fire fighting equipment. Staff-training to meet any emergency that may develop is an essential part of adequate protection.

Education programs have been carried on to the end that fires in the home may be prevented. Recommendations far reaching in their importance deal with care in the use of matches, lights, open fires, cooking, cleaning, and every activity centered about the operation of a household. Studies likewise have been made dealing specifically with farms. These involve not only the hazards of the household but many peculiar to the farm itself, such as, for example, the danger of fire from static electricity in threshing operations. Gasoline hazards evidence themselves where motors are used in farm operations. Details of construction and the need for lightning protection are studied. The examples are indicative to the approach to the subject.

The special fields of research are many. Those mentioned above are indicated only as examples. In addition to hazards of construction, protection problems of special processes are studied; for example, those involving the use of magnesium, the bleaching of wool with hydrogen peroxide, synthetic rubber, and processes with a dust explosion hazard. Literally hundreds of publications ranging from pamphlet size to large volumes have been prepared to assist property owners in their protection problems.

Arson Investigations. In the early days of fire insurance underwriting, one of the most perplexing problems to develop was to be found in the prevalence of arson used as a means to defraud insurance companies. With the organization of the National Board of Fire Underwriters, the investigation of arson became one of its primary functions. The board, today, through its Committee on Incendia-

rism and Arson, maintains a corps of investigators who are available to render aid to public authorities in the investigation and prosecution of arson and kindred crimes. The services of these investigators are by no means limited to cases involving fire insurance. The entire arson prevention program is predicated on the belief that public interest requires the reduction of fire losses to a minimum and the belief that organized arson and professional arsonists can and should be eliminated.[15] The board has been an important factor in bringing about convictions and this fact, coupled with the knowledge of the board's work by those who may be tempted to use arson as a means of fraud or revenge, has unquestionably saved countless sums through the elimination of professional arsonists. The setting-up of a fear of almost certain conviction in the minds of many individuals who might otherwise resort to arson to defraud insurance companies[16] has unquestionably been a deterrent to this form of crime.

Arson is one of the most difficult criminal acts to prove. In the ordinary course there are no witnesses, and it is usually necessary to establish the commission of crime by means of circumstantial evidence. Arson investigation, therefore, is a highly technical occupation. In many instances great difficulty in effecting convictions is the outgrowth of the nature of the law in the jurisdiction. Arson, at common law, is the willful and malicious burning of the house of another. By statute in some states arson is defined as "The malicious burning of the dwelling or certain other buildings the property of another." The definition has been broadened in a Model Arson Law in which it is provided that "the malicious burning of a building is arson, regardless of the ownership or occupancy." The support of the insurance business of this law and its widespread adoption has gone far to take the possibility of an arson conviction out of the realm

[15] National Board of Fire Underwriters, *Suggestions for Arson Investigators,* (New York, 1944), p. 3.

[16] It is a matter of common knowledge that at one time professional arson rings were in operation. Solicitors made contact with prospects and offered to burn properties for a percentage of the insurance. In the case of fire resistive structures and sprinklered risks they would go so far as to guarantee a total loss. Cases are on record where a long period of time was utilized in preparation for the fire including the filling of the sprinkler system with gasoline and placing explosives under bearing walls and columns. To the National Board of Fire Underwriters goes a large degree of the credit for stamping out these rings. Whenever evidence of their reappearance manifests itself the board immediately sets its investigators to work and in the ordinary course the antisocial activities are terminated.

of the virtually impossible.[17] The amounts that have been saved to society through the work of the insurance industry in this field are beyond calculation; nor is the saving limited alone to property values. The record of lives lost as a result of arson, or attempted arson, paints an appalling picture. Frequently, the occupants of destroyed buildings have been burned to death. Again, arsonists using highly inflammable materials have caused explosions that brought about their own deaths. The social gains effected by making arson unprofitable and unattractive must be regarded as very substantial.

Fraudulent Claim Service. Closely akin to the work of the fire insurance companies in the field of arson, the casualty and surety companies have instituted a service allied with their claims work designed to detect and prevent fraudulent claims. The claims bureau co-operates with law enforcement officers at all government levels, as well as with bar associations and medical societies, with a view to suppressing criminal activities making any use of the casualty insurance business.

Some years ago "claim faking," together with unethical professional activities that led to the development of claim rings, reached an appalling state. Bar associations, medical societies, as well as law enforcement officers, were called upon to co-operate. As one of the steps to eradicate criminal activities involving casualty insurance claims the "Index System" of the association was organized. The Index System keeps current a complete record of all personal injury claims. It maintains a staff of trained investigators and is constantly in co-operation with district attorneys, federal agencies, and state or municipal police facilities. The organization has been instrumental in breaking up claim rackets and has successfully prosecuted those responsible for their organization. It is not claimed that insurance frauds are thus completely eliminated, but the companies through this organization have succeeded in making the business of fraudulent claims a discouraging and dangerous enterprise.

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[17] For a draft of the Model Arson Law see *Suggestions for Arson Investigators*, pp. 44–45. The law—at least as regards its salient features—is in effect in the following thirty-nine states: Alabama, Arkansas, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming.

The Index System maintains a record of claims that now is in excess of 8,000,000.[18] It is pointed out that the system not only tends to prevent loss to insurance companies as well as to insureds by preventing fraudulent claims but also serves to accelerate the payment of just claims through providing a means for the quick detection of fraud where suspicion exists.

The National Safety Council. This organization is a noncommercial, nonprofit association which has for its function the sponsoring of the safety movement in America. Its purpose is to reduce the number and severity of all kinds of accidents. The work of this bureau is closely allied with the interests of the National Bureau of Casualty and Surety Underwriters. The insurance business is keenly interested in the work of this organization and other organizations having similar purposes.[19] The activities of the National Safety Council are conducted on a nation-wide basis. Through research and the accumulation of statistical data bearing upon old and new hazards, recommendations are made to the end that safe equipment may be installed and safe procedures followed. The council prepares engineering and professional materials for the education of specialists in safety and prepares a wide range of educational material designed to secure the co-operation of industrial workers, their families, and the general public.[20]

Automobile Driver Educational Program. The automobile drivers' training program, sponsored by the education division of the National Conservation Bureau,[21] is a comprehensive program of accident prevention. The program undertakes to make driver education a separate credit subject in the high-school curriculum or to make it an integral part of some other course, such as health, physical education, or programs of democracy. The bureau feels that nation-wide driver education at the high-school level will, in the course of a very few years, so improve the general standard of driving as to

[18] Association of Casualty and Surety Executives, *In the Public Service* (New York, n.d.), p. 20.

[19] Casualty insurance underwriters are devoting every effort to effect a solution of the accident problem to the end that a reduction will be effected in the toll of loss of life and limb and accompanying economic loss. Organizations other than the National Safety Council with whom the insurance underwriters are working include the National Conference of Street and Highway Safety, the Chamber of Commerce of the United States, United States Automobile Chamber of Commerce, American Road Builders Association, and the Society of Automotive Engineers.

[20] National Safety Council, Inc., *Safety Services for Industry* (Chicago, n.d.), p. 2.

[21] Sponsored by the Association of Casualty and Surety Executives.

achieve a marked over-all improvement with a corresponding reduction in traffic accidents.[22] That this educational program will have a profound effect upon the driving habits of any community, in which it is established, goes without saying. It has also been suggested that, entirely aside from its effect upon the young people participating in the courses, its influence reaches the entire community through parent-teacher groups and the interest evidenced by all members of the family. It is further pointed out that driver education in high schools provides a nucleus for safety training in other fields of endeavor. The program is unquestionably a constructive contribution of the casualty insurance business.

The insurance industry has also interested itself in the program for post-war traffic safety. Aside from the immediate necessity of taking such safety measures as can be worked out, it is recognized that automobile traffic has certain long-term problems. These include, among other things, greater traffic volumes, changes in traffic parking patterns, new developments in the automobile, the relationship between the use of alcohol and automobile accidents, as well as night driving hazards.

Elements of the post-war traffic program now being studied include such steps as: new road construction; betterment of existing streets and highways; traffic engineering administration; police personnel and equipment, techniques, and enforcement; vehicle inspection; driver licensing; traffic safety instruction; traffic safety education; and a legislative program. It is emphasized that effective post-war traffic safety planning demands concrete and decisive action.[23] The insurance industry is definitely interested in this program.

The Physically Impaired. The work of casualty and surety com-

[22] Recognizing the need for driver training, the bureau points out that during five years ending in 1943 persons 15 to 24 years of age were involved in traffic accidents which killed 27,170 and injured 1,311,000. In the course of one year 43 per cent of all accidental deaths in the 15 to 24 age group resulted from traffic accidents. The bureau published in 1936 the first edition of its textbook, *Man and the Motor Car,* designed to provide constructive material on skillful driving. The text is a most comprehensive study of the problem. There is provided as well supplementary teaching materials. The teacher's manual is a most comprehensive affair. The program is set up on a national scale, and it has recently been reported by the association that 5,000 high schools in 23 states are teaching driver education using *Man and the Motor Car* as the basic test.

[23] *A Program for Post War Traffic Safety* (sponsored by 47 national organizations), published for the sponsoring organizations by the National Safety Council, Inc. (Chicago, n.d.), p. 16.

panies, in co-operating with employers to the end that productive employment can be given to the physically impaired, has salvaged for industry a large group of capable workers, that might otherwise have been lost, and at the same time has contributed to an immeasurable degree to the independence and well-being of an enormous number of individuals.[24]

Studies have been made of the reliability of physically impaired workers as compared to normal workers. These studies have brought out the fact that the physically impaired worker has a superior record in the fields in which he is employed.[25] Community plans have been encouraged, designed to provide employment for the disabled worker. Surveys have been made of job requirements with a view to specifically fitting impaired workers into positions for which they are qualified. Industries are encouraged to set up a special program with provision for interviewing the impaired worker and analyzing his physical capabilities. Planned procedures are recommended for acquainting the worker with his job. It is recommended that assignments be followed up by the personnel department, the safety department, and in some instances by the medical department of the company. The follow-up is recommended as a periodic procedure until the placement seems definitely certain.

The wide experience of the surety companies is made available to insureds. Companies are able to make known, out of their experience, the special safety precautions necessary for the protection of the physically impaired worker. They are also able to point out the type of work adapted to the various impairments, to the end that the impaired worker is placed in a safe occupation. The insurance companies have demonstrated that, given the right job and training, the impaired worker will with respect to it no longer be handicapped.

Making America Health Conscious. The contribution of the life insurance industry to the general health of the community is well-nigh incalculable. Some of this work is carried on as a co-operative enterprise. In other instances, large life insurance companies

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[24] The Association of Casualty and Surety Executives estimates 1,250,000 disabled veterans in addition to the normal number of physically impaired. The National Health Survey estimated in 1940, 623,000 persons with major impairments and 4,374,000 with minor impairments. Including the disabled veterans, there are 6,250,000 physically impaired persons. This represents nearly 5 per cent of the population.

[25] Association of Casualty and Surety Executives, *The Physically Impaired, a Guide Book to Their Employment* (1945), p. 1.

have undertaken their health conservation activities on an individual basis.

The activities range from the conducting of research on epidemics to co-operation with safety groups, health departments, and their local organizations with a view to inviting attention to the hazards of home accidents and, hence, eliminating or preventing them.[26] Periodic health examinations provided for by certain of the life insurance companies have expanded to the point where the privilege is now made available to policyholders estimated to number many millions. Some of the companies have carried on extensive analyses of the information obtained from the periodic medical examinations of the policyholders with a view to making useful recommendations in the field of health conservation. Extensive recommendations have been made in specialized fields, such as those of cancer and silicosis.[27] Visiting nursing service has been an outstanding factor in health conservation.[28] The educational programs sponsored by life insurance companies have resulted in the distribution of tens of millions of pieces of literature designed to encourage better living, to outline health precautions for the prevention of disease, or to advise relative to proper care in time of illness. The educational programs have not been limited to the distribution of literature. The insurance industry has availed itself of almost every conceivable means of communication including the radio, exhibits, speakers at public gatherings, and the like.[29] Public health activities are co-ordinated with the work

[26] An outstanding example in this field is to be found in the accomplishments of the Aetna and Travelers insurance companies through the use of moving pictures, pamphlets, and surveys. The Aetna maintains a safety education department, and the Travelers an engineering and inspection division.

[27] Indicative of the work carried on in specialized fields is that of the Equitable Life Assurance Society. This company has recently conducted a study of the economic effect of the use of sulpha drugs on pneumonia patients. The research involved a study of the loss of time of wage earners and salary workers as a result of pneumonia.

[28] In a single year the Metropolitan Life Insurance Company alone is reported as having paid for over 3,000,000 visits by graduate registered nurses to sick policyholders in their homes. This service was commenced by the Metropolitan as early as 1909 for their industrial life insurance policyholders and more recently the John Hancock has followed the example. This service is provided by a number of other companies for group policyholders.

[29] A large number of insurance companies provide informative material on personal hygiene, disease prevention, and sanitation. Among the companies that have issued booklets dealing with health conservation are the Connecticut General, John Hancock, Metropolitan, Penn Mutual, Prudential, and Travelers. In their literature these companies have treated such subjects as child care, diet, exercise, contagious diseases, and noncommunicable diseases. The Aetna Life and Metropolitan have produced moving pictures on health conservation.

of local health agencies, industrial groups, or educational institutions.

Much that the life insurance industry has been able to accomplish is the outgrowth of a sound public relations program. Companies, as individuals and associated as a group, have presented the story of life insurance and its advantages in a manner so convincing that it could not help but be heard. The recently organized Institute of Life Insurance, as a source of information in carrying the story of life insurance to the general public, is one of the outstanding developments in public relations in the field of American business. Not only has this organization been instrumental in presenting life insurance facts to the public at large, but it has also co-operated with individuals having specific problems or engaged in research activities touching upon the life insurance field. It has been an important source through which the benefits of life insurance have been made known to the American public, and information dealing with the specific programs of prevention have been given a wide distribution.

Medical Research Fund. One of the most recent and outstanding contributions in the field of insurance is to be found in the organization of the Life Insurance Medical Research Fund, with membership of 148 life insurance companies in the United States and Canada.[80]

The membership of the fund includes United States companies having over 92 per cent of the total amount of outstanding life insurance. The Canadian companies that are members of the fund contribute on the basis of their United States business.

The first project undertaken by the fund constituted research into the diseases of the heart and arteries. This field was chosen because of its primary importance to the public and, hence, to life insurance policyholders. These diseases constitute one of the primary causes of death in the United States. Life insurance records show that they are responsible for nearly one-third of all policyholder deaths and for the population as a whole are responsible for 400,000 deaths annually.

Recommendations for allocation of the funds are made by an advisory council consisting of eight distinguished medical men all connected with medical schools or universities. A committee of four life insurance medical directors co-operates with the advisory council

[80] At the time of its organization in 1945 it was announced that funds of more than $3,500,000 were in prospect for research over the six succeeding years. The annual contributions to the fund, amounting to $578,000, are the equivalent of the income at 3 per cent on an endowment of $19,000,000.

and the board of directors. It is the intention of the sponsors to allocate money to support men in research who otherwise would not be able to enter the field. Researchers thus financed are to be known as "Life Insurance Medical Research Fellows."

Wartime Activities. Activities in the field of loss prevention during wartime have amounted to an intensification of normal activities directed to the special needs of war. It has been said:

> There are no welders, riveters, machinists, mechanics . . . . in the fire insurance business. No assembly lines loaded with tanks, airplanes or guns move throught its buildings. Its companies process no food, run no turbines, build no ships. Yet, they're in the war.[31]

Of particular importance was the National Bureau for Industrial Protection. This organization, set up in Washington, carried on its activities on a nation-wide basis. The bureau was maintained by all classes of fire, casualty, and boiler insurance companies and had for its purpose the provision of engineering assistance designed to safeguard production in manufacturing plants and the stock piles of critical materials. Inspection reports of insurance engineers were made available to the government. The work of this bureau included safety and antisabotage work, as well as the normal safety and prevention activities usual in peacetime operations. Specialists from the insurance organizations were available to advise government officials, architects, and contractors in the construction and protection of war plants. This service was rendered whether the plants were insured, or government owned and without insurance.[32] Every field of insurance endeavor contributed to this work, and it has been held up as an outstanding example of co-operation. There were specialists in the organization from the fields of fire, casualty, surety, and boiler insurance companies, as well as representatives of both stock, mutual, and reciprocal organizations. This co-operative undertaking was carried on, on a nation-wide scale. It is estimated that approximately 5,000 fire and accident prevention specialists, employed by insurance companies in their regular service bureaus and working in every state in the union, contributed to the successful operation of this bureau.

The business of life insurance during the second World War

[31] National Board of Fire Underwriters, *Ashes Make Poor Gunpowder* (New York, n.d.).

[32] It is reported that the bureau furnished over 63,000 technical reports to various government agencies and departments.

organized the "keep-well crusade." Through the activities of the National Association of Life Underwriters over two hundred committees were set up having for their avowed purpose the conservation of the health resources of the country, to the end that the maximum demand for war workers could be met.

It is hard to estimate the importance of the accomplishments of these committees. Hundreds of thousands of posters were distributed that served as constant reminders to millions of people that keeping well was of paramount importance for the war effort and indicating basic fundamentals by which the end could be accomplished. Millions of small leaflets were distributed, and it is estimated that in this way ten million persons were reached. Use was made of the radio, news items, and a wide range of other publicity channels. This work was an intensification of the public health program that is constantly a part of life insurance activities. The momentum that it attained during the war years may reasonably be expected to carry far beyond its immediate purpose of keeping war workers well, on the job.

Far-Reaching Implications of Loss Prevention. Loss prevention activities have implications more far reaching than the preservation of physical property. In the United States the fire loss in 1945 was just under a half a billion dollars—this in spite of the constant pressure on the part of insurance organizations to effect loss reductions. Home fires alone destroyed property valued at $123,500,000. To the National Association of Credit Men is attributed the statement that a saving of $250,000,000 annually in fire waste means a gain of close to a billion dollars in business. Aside from the material aspects of physical property, the ramifications of loss prevention in the business field are tremendous. Loss of life from fire is nothing short of appalling. Estimates of the National Board of Fire Underwriters indicate twenty-seven lives lost each day in fires. The total number of lives lost each year is in excess of 10,000. The number of lives saved and the number of injuries prevented through the fire prevention activities of the insurance industry are beyond calculation.

According to the National Safety Council, entirely aside from industrial accidents, there were approximately 32,000 accidental deaths in a single year resulting from home accidents. Nonfatal injuries resulting from home accidents totaled 4,800,000, including approximately 130,000 which involved some permanent disability. The estimated cost of home accidents amounted to approximately

$600,000,000 in wages lost, medical expenses, and insurance overhead costs. American workers hurt on the job in a year reached the figure of 1,900,000. American workers hurt off the job reached the startling figure of 2,300,000.

The extent to which these losses have been minimized by preventive activities is impossible to measure. The extent to which they can be further reduced by the educational activities of insurance and other safety organizations will represent an important contribution to the social and economic well-being of every community.

FOR REVIEW

1. In a publication of the Atlantic Mutual Fire Insurance Company, the following statement appears: "It's a wonderful thing for an automatic sprinkler to lose its head when a fire occurs, but costly and often tragic for a human being to do so." Discuss this significant statement.
2. The destructive power of fire is seldom instantaneous. Its spread is said to be very nearly a geometrical progression. What is the significance of this statement?
3. A publication of the National Board of Fire Underwriters under the heading "A Street of Desolation" points up the terrific extent of the social and economic loss caused by fire in the following powerful words: "The buildings burned, if placed on lots of 50 feet frontage, would line both sides of a street extending from New York to San Francisco. A person journeying along this street of desolation would pass in every quarter of a mile a ruin from which an injured person was taken. At every third of a mile in this journey he would encounter the charred remains of a human being who had been burned to death." Discuss from the standpoint of fire prevention.
4. In a publication of the National Board of Fire Underwriters entitled *Safeguarding the Farm against Fire* it is stated: "If the average man, even a city dweller, were asked what he believed to be the greatest fire hazard on the farm he probably would name lightning, and until recently he would have been correct." Why is lightning no longer the greatest hazard?
5. Society has a responsibility to the physically impaired. Entirely aside from the humanitarian aspects indicate another aspect of this responsibility.
6. During the war, when war production plants were expanding at a rapid rate, the need developed for fire prevention and accident prevention services equipped with special engineering facilities. Insurance company fire and accident prevention engineers were recruited to assist. Discuss the services you think that trained insurance men could render in such an emergency.
7. How can fire prevention inspectors and fire department officers in their routine work contribute to the efficiency of a salvage corps?
8. It is virtually impossible in a large number of cases where arson is believed to be the cause of a loss to secure a conviction by direct and positive evidence. Only skilled investigators, in many instances, are able to place together the

fragments of circumstantial evidence to the end that the guilty party can be identified. Is this means of identification of value, in the absence of direct evidence, in securing a conviction?

9. Insurance companies are advised to preserve letters, proofs of loss, or other material sent them through the mails in instances where arson is suspected. Why?
10. On July 28, 1945, at about 9:25 A.M. a United States Army Air Force bombing plane crashed into the upper portion of the Empire State Building. Gasoline spread over the upper part of the structure and portions of the seventy-eighth and seventy-ninth floors were the site of a furious fire. Water was available from a good standpipe system, and the fire-resistive structure of the building enabled the fire department to prevent the spread of fire to other portions of the building. There was grave danger, however, of water damage. In a blaze that threatened great damage, how could this be minimized?
11. How does insurance encourage eliminating or reducing risk?
12. The Factory Insurance Association states: "Good housekeeping and self-inspections protect personnel—production—payrolls—profits." From your own observations, offer suggestions for good housekeeping in industrial plants that will tend to eliminate losses.
13. A great deal is said about the accident prevention activities in American industry. Do we have any reasonable assurance that these activities actually bear fruit?
14. B's plant is protected by an automatic sprinkler system. His insurance rate has thereby been lessened, and he has a feeling of great confidence that any loss because of fire will be checked almost immediately by the sprinkler system. Is this feeling justified?
15. Indicative of the fact that carelessness is a cause of much of the fire loss in this country, the National Board of Fire Underwriters points out that smoking caused 29.44 per cent of all fire claims reported to the board in the ten-year period from January 1, 1935, to January 1, 1945. Indicate from your experience some of the other causes of preventable fire.

CHAPTER VI

INSURANCE REGULATION

INSURANCE Subject to Regulation. Insurance as interstate commerce is subject to regulation by Congress. As a matter of practice, the business of insurance is regulated by the states. The business, however, is subject to the federal antitrust laws and to certain other federal regulatory statutes dealing with interstate commerce. The status of insurance, as subject to federal regulation, dates from the Supreme Court decision in the case of *United States* v. *South-Eastern Underwriters Association et al.*,[1] handed down in a precedent shattering decision on the fifth day of June, 1944. This decision, now known familiarly to the legal profession and to the insurance business as the S.E.U.A. case, held insurance to be commerce and, because of its interstate nature, subject to federal regulation. Heretofore, insurance had been held not to be commerce. To understand the present status of regulation, it is necessary to review briefly the background of this development.

Inception of State Regulation. Regulation of insurance by states, as we understand regulation today, had its inception about ninety years ago. In New Hampshire legislation was enacted establishing the first board of insurance commissioners in 1851.[2] Massachusetts followed in 1852,[3] and Rhode Island in 1856.[4] However, legislation regulatory in nature made its appearance far earlier. The first regulatory statutes in the United States are ordinarily regarded as the legislative enactments chartering the early stock insurance companies.[5] The Insurance Company of North America, the first such company to be incorporated in the United States, received its charter April 14, 1794. By statute, limitations were placed upon the investments of the company, the real estate it could hold, the depository of its funds; and provision was made for a reserve for losses. The action of Pennsylvania was followed in other states, and it became customary

[1] 64 Sup. Ct. 1171 (1944).
[2] N.H. L. 1851, c. 1111.
[3] Mass. L. 1852, c. 231.
[4] R.I. L. 1854, sec. 17.
[5] Patterson, E. W., *The Insurance Commissioner in the United States* (Cambridge: Harvard University Press, 1927), p. 523.

in granting charters to insurance companies to make provisions to provide for the solvency of the company.[6] Other early statutes were enacted. The business of insurance soon attracted the attention of taxing authorities as a source for revenue.[7] When licenses were issued, it became the custom to secure evidence of financial responsibility. That insureds had a responsibility to the public, in which the governing authority had an interest, made its appearance almost coincident with the development of the insurance idea as a business institution.[8] In this country, however, the serious regulation of the business as a state function dates with the establishment of the state insurance departments. Since their first appearance until the present time, insurance has been so regulated; and until the decision in the S.E.U.A. case such regulation was regarded as the exclusive function of the states.

The Insurance Department. Toward the middle of the nineteenth century the insurance business began to reach a size and importance that gave continued emphasis to a public interest. The recognition on the part of legislative authority to the co-operative nature of the business, together with the disastrous experience of failures, the outgrowth of rate wars, and other unhealthy competitive practices, made it increasingly apparent that, if the business of insurance was to retain public confidence—in fact, if the business were indeed to survive—regulation, far more reaching in its operation than had heretofore been in vogue, would be imperative.

The first state insurance department was organized by Massachusetts in 1855, followed by New York in 1859. The first officials appointed for supervision in Massachusetts were the secretary, treasurer, and auditor of the commonwealth. These officials were appointed in 1852 to constitute a board of insurance commissioners. It was not until 1855 that an independent insurance department was created. As early as 1851 the state of New York required life insurance companies to deposit with it a fixed sum in approved securities as a condition precedent to securing authority to do a life insurance business in that state. Prior to 1859, other laws were enacted setting forth the conditions required for the organization or operation of an

[6] *Ibid.*

[7] *Ibid.*, p. 524, citing Pa. L., 1809–10, c. 59, p. 81.

[8] It is an interesting commentary on insurance regulation that the earliest known statutes dealing with the subject of insurance treat of insurance regulation. These were the Barcelona Statutes of 1458, 1461, and 1484. *See* Chapter I.

insurance company. There were, however, many failures—some tainted with fraud, others the outgrowth of inefficiency or unscientific management—and the necessity for actual supervision was indicated. In due course, other states followed Massachusetts and New York in establishing insurance departments—Connecticut in 1865, Ohio in 1867—until eventually the business of insurance was under the direct supervision of state authorities in every state in the Union.

Early in the course of development of regulation it was recognized that the insurance business, as it was developing, tended to become interstate in its operations. Those most intimately associated with the business and the development of regulation saw the possibilities of confusion arising from state control and were, from the earliest days, advocates of federal regulation. Probably the first formal recommendation looking toward federal regulation was that made in 1865 by Elizur Wright, whose name will remain inseparably associated with the development of insurance regulation. A graduate of Yale, his family expressed the wish that he become a Presbyterian clergyman. Feeling that his vocation was not in the ministry, Wright became a professor of mathematics and, in the course of his studies and research, interested himself in the mathematical aspects of life insurance. He was one of the prime movers in urging the establishment of the Massachusetts insurance department and served for a period of eight years as one of the two commissioners of insurance. It is stated of him that he was a man of strong character, who was able to discern abuses. He so forcibly presented his view to the legislature that he was able to secure passage of some of the most important of the laws now in effect that have put the business of life insurance on a sound and equitable basis.

Following Wright's recommendations, a bill designed to effect federal control was introduced in Congress but failed of adoption. From time to time, other bills have been introduced for the same purpose but in every instance failed to be enacted into law. An amendment to the Constitution designed to bring insurance under the regulation of the federal government was proposed to Congress in 1914; but the movement has been, up to now, without effect.

Aim of State Regulation. States in attempting to regulate the business of insurance have undertaken, first, to maintain the solvency of the insurers so that they may be able to meet claims when they develop, and, second, to provide safe insurance on a reasonable, fair,

and nondiscriminatory basis. To do this, it is expected that the rates will be predicated upon the measure of the risk involved.[9]

The early attempts to establish rate making on a sound basis through the establishment of the various regional organizations entrusted with the responsibility of rate making generated a hostility on the part of the public to insurance co-operation. Opposition was voiced on the ground that co-operative action was monopolistic and and contrary to the public interest. As the outgrowth of this opposition various state legislatures undertook to prohibit co-operative rate making by the enactment of bills that came to be known as "anti-compact laws." In the belief that the public would be served best by unrestricted competition, twenty-two states enacted statutes prohibiting combinations between insurers for the joint fixing of rates.[10]

By 1911 it began to become apparent that unlimited competition, far from reflecting to the public interest, could, on the contrary, be injurious. The changing attitude was reflected in the legislative committee reports.[11] The tide began to turn when insurance com-

[9] The basic standards for making fire insurance rates are set forth in Article VIII of the New York Insurance Law, as revised in 1939, in the following divisions of § 183 (1):

"(*b*) Rates shall be reasonable and adequate for the class of risks to which they apply.

"(*c*) No rate shall discriminate unfairly between risks involving essentially the same hazards and expense elements or between risks in the application of like charges and credits.

"(*d*) Consideration shall be given to the past and prospective loss experience, including the conflagration hazards, if any, both within and without this state; to all factors reasonably attributable to the class of risks; to a reasonable underwriting profit. . . . ."

[10] Alabama, Arizona, Arkansas, Georgia, Iowa, Kansas, Louisiana, Maine, Michigan, Mississippi, Missouri, Nebraska, New Hampshire, Ohio, Oregon, South Carolina, South Dakota, Tennessee, Texas, Virginia, Washington, and Wisconsin.

[11] A case in point is the 1911 Merritt Committee Report. This report at page 44 stated:

"The actual working of anti-compact laws has not been satisfactory; they have not decreased rates and they have greatly increased discrimination; they have taken the rate-making out of the hands of the companies; who were in direct contact with the business and put it in the hands of persons who had no way of testing by experience the rates which they made, and who furthermore did not stand in such relation to policy-holders as to feel the force of public opinion.

"It is well recognized that in general anti-compact laws have been a failure and there is noticeable a distinct reaction against them."

Five of the states having anti-compact laws have formally repealed them (Alabama, Maine, Mississippi, Tennessee, and Virginia). Of the remaining seventeen states, eleven (Arkansas, Kansas, Louisiana, Michigan, Missouri, Ohio, Oregon, South Carolina, South Dakota, Washington, and Wisconsin) have restricted their anti-compact laws by requiring or permitting fire insurance companies to become members of rating bureaus. In no state is unlimited competition the rule, nor in any are anti-compact or antitrust laws operative.

missioners realized the importance of safeguarding the solvency of the companies and ending the practice of rate discrimination. Laws were then enacted authorizing the association of companies in the making of rates.

With the failure of anti-compact legislation, it was found that insurance companies could be protected from the disastrous consequences of unrestricted competition through the organization of rating bureaus, whose promulgated rates would be predicated upon statistical information accumulated from all available sources and upon the loss experiences of member companies.[12]

In protecting the solvency of companies, even in those states where the anti-compact laws have not actually been repealed, the idea of competitive rate making has for some years been abandoned.[13] It was felt by the state regulatory authorities that collaboration in rate making was absolutely essential. Such collaboration was regarded by many as contrary to the provisions of the federal antitrust laws; but, because of a series of Supreme Court decisions, presently to be noticed, the antitrust laws were held not to apply to insurance. The policies of regulation established by the states were generally regarded as not being, in any sense, contrary to the public interest.

Nature of Supervision. The regulation of the business of insurance as heretofore carried on by the states is effected: first, through the enactment of laws having a general or specific application; and, second, through the application of many broad discretionary powers, delegated to the insurance commissioner or other officer entrusted with the enforcement of insurance regulatory legislation.

Insurance legislation has not attempted to prescribe details of management but rather has set up certain standards designed to safe-

[12] At the time of the S.E.U.A. decision 27 states and the District of Columbia were required by law to provide rating bureaus for fire insurance companies. In only two states (Nebraska and Iowa) were they prohibited. In 29 states and the District of Columbia, fire insurance companies were not allowed to deviate from the rates promulgated by the rating bureau except with the approval of the state insurance department. This last regulation was to prohibit rebating and discrimination. In some instances, in the interest of preserving solvency insurance commissioners had the power to compel rate increases.

[13] Seven states still have anti-compact statutes on their books or anti-monopoly statutes corresponding to the federal antitrust act. The states, however, have not applied these acts to co-operative rate making in the field of insurance. The development of different forms of schedule rating followed with legislation which, if it did not repeal the anti-compact laws, was regarded as having superseded them by the recognition of the bureaus which easily were subject to some measure of supervision by the state authorities.

guard the interest of the policyholder and, at the same time, make for stability in the business. The procedure held to evidence the best practice calls for the setting-up of certain standards for the companies to meet; steps having been taken to see that these requirements are satisfied, supervision should end. The principles have been set forth in the carefully worded report of the Armstrong Committee in the following terms: "The legislature cannot undertake the management of the business. In seeking to secure economical administration it should not overstep the line which divides State supervision from an utterly impractical effort to prescribe details. The legislature should aim to permit freedom of management subject to general regulations and complete publicity." Some of the more important statutes touching upon the regulation of insurance include: (*a*) laws governing the organization and liquidation of companies; (*b*) laws covering the examination of companies to determine their financial condition; (*c*) laws setting up standards of solvency; (*d*) laws governing the distribution of dividends; (*e*) laws regulating the nature of investments; (*f*) laws regulating the operation of the business covering such items as salaries, commissions to be allowed agents, rebating, and the like; and (*g*) laws requiring annual reports supplying information deemed necessary by the insurance departments.[14]

Regulation, as it has developed, has thus been summarized:

> Generally speaking, State regulation includes provisions for insurance departments (now existent in all States); laws and regulations relating to joint determination of reasonable and equitable rates; the adequacy of rates; commissions to agents and other acquisition costs; rebating; unfair discrimination; the filing of rates, plans, rules and regulations and other information and data for public inspection; the creation and maintenance of, or provision for, organizations or bureaus for promulgating uniform rates and the supervision of the issuance of policies in conformity with applicable rules and regulations; the qualifications necessary for the admission of fire insurance companies to do business; the qualifications of agents of fire insurance companies; the special taxation of fire insurance companies, domestic and foreign; the filing of special reports by fire insurance companies; standardized types of policies and forms of fire insurance coverage; dividends of participating insurers; and control of reserves and investments.[15]

It has been contended that in the case of insurance, because there

[14] Armstrong Investigation, *Report of the Committee*, chap. i, p. 20.

[15] "Brief for Appellees" in the Supreme Court of the United States, *United States of America* v. *South-Eastern Underwriters Association et al.*, p. 48.

is no right to demand and receive services on the part of the public, there is no correlative right of regulation on the part of the state. It is held, however, that the business of insurance is affected with a public interest and is, in consequence, subject to regulation. The attitude of the courts is summarized in *German Alliance Ins. Co.* v. *Lewis*:

> We need only say that there was quite early (in Massachusetts, 1837, New York, 1853) state provision for what is known as the unearned premium fund or reserve; then came the limitation of dividends, the publishing of accounts, valued policies, standards of policies, prescribing investment, requiring deposits in money or bonds, confining the business to corporations, preventing discrimination in rates, limitation of risks, and other regulations equally restrictive. In other words, the state has stepped in and imposed conditions upon the companies, restraining the absolute liberty which businesses strictly private are permitted to exercise.

The court then added:

> Those regulations exhibit it to be the conception of the law-making bodies of the country without exception that the business of insurance so far affects the public welfare as to invoke and require governmental regulation. A conception so general cannot be without cause. The universal sense of a people cannot be accidental; its persistence saves it from the charge of unconsidered impulse, and its estimate of insurance certainly has substantial basis.[16]

Whatever regulatory action is taken in exercise of the police power has the support of the presumption that the action is in the interest of the public.[17] This presumption attaches not only to the orders of administrative bodies but also to statutes and municipal ordinances.[18]

The Paul Decision. In 1868 the United States Supreme Court in the classic case of *Paul* v. *Virginia*[19] decided that insurance is not commerce. The case was brought to the court as a result of the following circumstances. In 1866 one Paul, of Petersburg, Virginia, was appointed by companies in New York to carry on a general fire insurance business. He did not obtain a Virginia license because he refused to deposit certain securities required by the Virginia statutes before a license would be granted. He continued to carry on his business and as a result was indicted. The matter was far more im-

[16] 233 U.S. 389; 34 S. Ct. 612 (1913).
[17] *The Erie Ry. Co.* v. *Williams*, 233 U.S. 685 (1914).
[18] *Pacific States Box & Basket Co.* v. *White*, 2 U.S. 176 (1935).
[19] 8 Wall. 168 (1869).

portant than simply a deliberate violation of the law by a single individual. The companies he represented interested themselves. The National Board of Fire Underwriters financed the litigation that had for its aim the determination of the legal status of a corporation doing business in a state other than that of its creation. The insurance companies wished to avoid the limitations of the state statutes. The Paul case reached two conclusions: (1) that a corporation is not a citizen within the purview of the clause of the Constitution respecting privileges and immunities of citizens in the several states; and (2) that the issuing of policies of fire insurance is not commerce.

The section of the decision dealing with commerce has long since become famous in the fields both of law and of insurance. Recognizing that corporations may claim the benefits of the commerce clause, Justice Field in writing the opinion of the court stated:

> Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them. They are not commodities to be shipped or forwarded from one State to another, and then put up for sale. They are like other personal contracts between parties which are completed by their signature and the transfer of the consideration.

This probably would have been sufficient to dispose of the case; but Mr. Justice Field, with a dictum which has been open to question, continued:

> Such contracts are not interstate transactions, though the parties may be domiciled in different States. The policies do not take effect—are not executed contracts—until delivered by the agent in Virginia. They are, then, local transactions, and are governed by the local law. They do not constitute a part of the commerce between the States any more than a contract for the purchase and sale of goods in Virginia by a citizen of New York whilst in Virginia would constitute a portion of such commerce.[20]

It has been many times suggested that the Paul dictum could not have made its appearance under present-day conditions. At the time of the Paul decision the court was evidently faced with upholding the right of a state to regulate the business of corporations chartered

[20] For comment on this dictum see Powell, T. R., "Insurance as Commerce," 42 Harvard Law Review 939.

in another state. As the law then stood, it was the alternative of state regulation or no regulation. In stating that issuing of policy of insurance was not a transaction of commerce, the court, at the time, in the light of existing conditions, seemed to stand on fairly firm ground. To say that the transactions were not interstate even though the persons were domiciled in different states has always been open to question. As time went on and the business of insurance grew to the point where it became an institution national in character, the Supreme Court doctrine became less logical.[21] The Paul decision became increasingly subject to critical scrutiny, and the illogical inferences of the dictum could not be squared with the actual fact that certain phases of insurance, at least, constituted interstate commerce.[22] The legal fiction to which the decision gave rise came to be known as the "Paul doctrine."

The Insurance Cases. For seventy-five years the Supreme Court in a series of cases that have come to be known as the "insurance cases"have upheld the right of a state to regulate the business of insurance. These decisions have held that insurance was not commerce or, in any case, not interstate commerce or trade.[23] These cases take their point of departure from the Paul case and represent a series of decisions which are the outgrowth of efforts on the part of insurance companies to avoid features of state laws that were held by them to be objectionable. So long as insurance was held not to be commerce, the early theories held that, if there was to be any regulation at all, the regulation rested with the states. In other words, so long as insurance was held not to be commerce, and, even further, if it were commerce held not to be interstate in its nature, then it was beyond the power of the federal government to regulate.

In the Paul case, as has already been noticed, it was said: "Issuing a policy of insurance is not a transaction of commerce." The courts

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[21] Willoughby, W. W., *The Constitutional Law of the United States* (New York: Baker, Voorhis & Company, Inc., 1929), Vol. II, p. 745.

[22] Watson, D. K., *Constitution of the United States: Its History, Application and Construction* (Chicago: Callaghan & Co., 1910).

[23] *Liverpool & London Life & Fire Ins. Co.* v. *Mass.*, 10 Wall 566; 19 L. Ed. 1029 (1871); *Ducat* v. *Chicago*, 10 Wall 410; 19 L. Ed. 972 (1871); *Phila. Fire Assoc.* v. *New York*, 119 U.S. 110 (1886); *Hooper* v. *California*, 155 U.S. 648 (1895); *Noble* v. *Mitchell*, 164 U.S. 367 (1896); *New York Life Insurance Co.* v. *Cravens*, 178 U.S. 389 (1900); *Nutting* v. *Mass.*, 183 U.S. 553 (1902); *New York Life Ins. Co.* v. *Deer Lodge County*, 231 U.S. 495 (1913); *Northwestern Mutual Life Insurance Co.* v. *Wisconsin*, 247 U.S. 132 (1918); *National Union Fire Ins. Co.* v. *Wanberg*, 260 U.S. 71 (1922); *Bothwell* v. *Buckbee Mears Co.*, 275 U.S. 294 (1927).

have repeated and enlarged upon this statement.[24] These cases and all the other cases in the *Paul* v. *Virginia* line were concerned with efforts of the insurance companies to escape strictures of state legislation. The last important case in the line is the Deer Lodge case; and this is particularly significant because, for the first time, a careful and painstaking exposition of the interstate character of a branch of business was presented.[25]

The Deer Lodge Case. This case was brought to the Supreme Court to obtain a reversal of a judgment of the district court. The case hinged upon a protest on the part of the insurance company that a Montana tax was unconstitutional and void as a burden upon interstate commerce and was contrary to and in violation of Section 8 of Article 1 of the federal Constitution.[26] The Montana court held that the business carried on by the insurance company was not interstate commerce and that the tax imposed could rightfully be regarded as a condition imposed by the state upon the company as a prerequisite of its carrying on its business with citizens of the state.[27] The action was brought against Deer Lodge County because under the Montana law the taxes were levied by the counties.

Like the Paul case, the Deer Lodge case was far reaching in its

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[24] For example, the court held: "The business of insurance is not commerce. The contract of insurance is not an instrumentality of commerce." *Hooper* v. *California,* 155 U.S. 648 (1895). Again "the business of insurance is not commerce. . . . ." *Noble* v. *Mitchell,* 164 U.S. 367 (1896), and yet again, "contracts of marine insurance are stated not to appertain to interstate commerce. . . . ." *Hopkins* v. *United States,* 171 U.S. 578 (1898). In another instance referring to life insurance the court stated: "That the business of life insurance is not interstate commerce is decided. . . . ." *New York Life Insurance Co.* v. *Cravens,* 178 U.S. 389 (1900). And still again the court repeats that "contracts of insurance are *not commerce at all, neither state nor interstate.* . . . ." *New York Life Insurance Co.* v. *Deer Lodge County,* 231 U.S. 495 (1913). And again, "A contract of insurance . . . . is not interstate commerce" *Bothwell* v. *Buckbee Mears Co.,* 275 U.S. 294 (1927). Finally, "the business of insurance has grown to vast proportions . . . . but insurance is not commerce. . . . ." *Colgate* v. *Harvey,* 296 U.S. 404 (1936).

[25] In addition to the insurance cases previously cited, the Paul doctrine has been upheld in the following decisions: *Engel* v. *O'Malley,* 218 U.S. 128 (1911); *Hill* v. *Wallace,* 259 U.S. 44 (1921); *Chicago Board of Trade* v. *Olsen,* 262 U.S. 1, 32 (1923); *Moore* v. *New York Cotton Exchange,* 270 U.S. 593 (1926); *Western Livestock Company* v. *Bureau of Internal Revenue,* 303 U.S. 250 (1937); *Ducat* v. *Chicago,* 10 Wall. 410 (1871); *Liverpool Insurance Company* v. *Massachusetts,* 10 Wall. 566 (1871); *Orient Insurance Company* v. *Daggs,* 172 U.S. 557 (1899); *Doyle* v. *Continental Insurance Co.,* 94 U.S. 535 (1877); *Blumenstock Bros.* v. *Curtis Publishing Co.,* 235 U.S. 436 (1920); *Federal Club* v. *National League,* 259 U.S. 200 (1922); and *Standard Oil Company* v. *United States,* 283 U.S. 163 (1931).

[26] "Brief for the Plaintiff-in-Error" in the Supreme Court of the United States, *New York Life Insurance Co.* v. *Deer Lodge County,* pp. 1, 2.

[27] *Ibid.,* p. 16.

significance. It was a carefully planned and worked-out attempt on the part of life insurance companies to end state regulation to the end that relief might be obtained from discriminatory or objectionable taxes. The state of Montana was selected in which to make the test; but if the case were won in Montana, the effect would be felt in all states. The case, therefore, was directed at all insurance legislation similar to that contested in Montana.

The Montana court upheld the Paul case, and an appeal was made to the Supreme Court. In the brief submitted by the companies, an attempt was made to show that life insurance as carried on at the time differed materially from the business of fire insurance at the time of the Paul decision. The line of argument was followed in the hope that a decision holding life insurance to be interstate commerce might be handed down without asking the court to reverse the Paul case and the subsequent insurance decisions. The action was unsuccessful. The court held in line with the previous insurance cases that "contracts of insurance are not commerce at all."

In writing the decision, the court reviewed the entire line of insurance cases. Emphasis was given, in the opinion, to the method of operation of the insurance business. In reaching the conclusion, it summarized the real issue before the court to be the maintenance of the right of states to regulate when it stated:

> It is true that the same specific issue was not involved in the twelve previous cases as was presented in the instant case, *but the same underlying question was decided;* whether the business of insurance is interstate commerce.
>
> In eight of the previous cases the question for decision was whether discriminatory state legislation as to foreign insurance companies doing business in the state was valid. If insurance was interstate commerce, the legislation was invalid as a discrimination against and a burden on interstate commerce. If insurance was not interstate commerce, the legislation was valid as a proper exercise of the right of the state to admit foreign insurance companies to do business in the state upon such terms as the state saw fit to require, as a foreign corporation is not a citizen within the meaning of the privilege and immunity clause of the Constitution, *Bank of Augusta* v. *Earle,* 13 Pet. 519, 10 L. Ed. 274, and many subsequent cases.

In unequivocal terms the court upheld the Paul doctrine thus:

> We, however, repeated that "the business of insurance is not commerce. The contract of insurance is not an instrumentality of commerce. The making of such a contract is a mere incident of commercial intercourse, and in this respect there is no difference whatever between insurance against fire and insurance

against 'the perils of the sea,'" and we added, "or against the uncertainty of man's mortality."[28]

When the Supreme Court decided against the company in the Deer Lodge case, it appeared to the insurance world that no other effort could possibly be made to overthrow the line of decisions stemming from the Paul case. Regardless of the course the business might take, insurance for all time was definitely "not a transaction of commerce." By the same token, insurance definitely was not subject to federal regulation but, in turn, under the police power could be regulated by the states.

Background of S.E.U.A. Complaints were filed with the Department of Justice late in 1941 that organizations of capital stock fire insurance companies had combined to fix premium rates which were unreasonably high and discriminatory and were engaging in coercive practices and boycotts restraining competition. Organizations had developed among insurance companies that unquestionably were in violation—in some, at least, of their practices—of the federal antitrust statutes. Insurance executives had long contended that the operations of these organizations were in the best interests of the business and enabled the business to serve the public well. To a large degree they were correct. The feeling, however, that need for corrective legislation was evidencing itself, continued to grow.[29] Action might have been deferred indefinitely but for an unfortunate development in which stock fire insurance companies were charged in Missouri with violation of the antitrust laws.[30] The Missouri authorities charged that certain insurance companies had entered into a

[28] *New York Life Insurance Company* v. *Deer Lodge County,* 231 U.S. 509 (1913).

[29] One of the practices complained of was known as "separation." If a company failed to comply with the rules of its organization, such, for example, as departing from the established rate schedule, the offending company was dropped from the organization, and any agency that represented it lost all member companies. If an agent undertook to represent a nonaffiliated company, stock companies in the association immediately withdrew from the agency. It was argued that "separation" was necessary to prevent unhealthy competition between companies with agents. Granted that such competition could become unhealthy, federal investigators were of the opinion that the use of "separation" as a trade practice was so applied as to constitute a violation of the antitrust statutes.

[30] The state of Missouri brought an action against 134 stock fire insurance companies in the so-called "Missouri Rate Cases." For a history of the "Missouri Insurance Scandals" see the withering statement of Judge Merrill E. Otis of the United States District Court for the Western District of Missouri in *United States* v. *Pendergast,* 39 F. Supp. 190, 191 (1941). See also *United States* v. *Pendergast,* 28 F. Supp. 601 (1929); *United States* v. *Pendergast,* 34 F. Supp. 269 (1940); *United States* v. *Pendergast,* 34 F. Supp. 593 (1940); *Pendergast* v. *United States,* 317 U.S. 412 (1943).

combination with the view to lessening free competition. As the investigation progressed and the interstate ramifications of the business came to light, the Missouri authorities began to feel that the problem was beyond the scope of a single state to reach a solution. Transcripts of testimony taken were furnished to the federal Department of Justice. No immediate action was taken by the department, but in due course a study was made which led to the conclusion that certain of the practices of the insurance companies were in violation of the Sherman Anti-Trust Act.

The Sherman Act forbids contracts or combinations "in restraint of trade or commerce among the several states."[31] But the "insurance cases" held insurance not to be commerce. The following syllogism developed: (*a*) Congress has a constitutional power only to regulate commerce among the several states; (*b*) insurance is not commerce; (*c*) therefore, Congress was without power to reach insurance, and the Sherman Act, therefore, was not violated by any acts of the insurance companies, regardless of their nature.

The crux of the problem was the dictum perpetuated in the "insurance cases" that insurance was not commerce. In the light of present-day interpretations this dictum was contrary to logical inference. In a memorandum recommending, among other things, the empanelling of a Federal Grand Jury to participate in the investigations, it was said in part:

> The elements of interstate commerce in the insurance business are plentiful. Realism compels this admission. Fire insurance companies, in the main, are large corporations with tremendous assets, doing business through agents in many states. The very character of this business itself should be sufficient to constitute interstate commerce within the meaning of the Sherman Act. The agent resides and operates in one state, the company maintains headquarters in a different state. Every risk on which the agent issues a policy is reported to the "Home Office" of the company by sending a copy of the policy through the mail to the State Actuarial Bureau, which forwards the copy to the "Home Office" of the company, receives commissions from the company, investigates claims of losses

[31] The pertinent provisions of the Sherman Act follow: "Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal: . . . . Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a misdemeanor, ... Sec. 2. Every person who shall monopolize or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor. . . . ."

and makes reports thereof to the company, receives funds for the payment of losses from the company and delivers the same to the insured. The final effectuation of all these steps is through the medium of interstate transportation. Without this medium, the great network of the insurance companies of this country would be compelled to cease operation within twenty-four hours.

We must not refrain because of apparent difficulties and uncharted seas. The opportunity to present the facts of this matter to the Court for consideration *de novo* is a challenge and a privilege. On the panel of the Department of Justice building painted by Mr. George Biddle, brother of the Attorney General, appear these memorable words of the late Justice Brandeis: "If we would guide by the light of reason, we must let our minds be bold." So be it.[32]

Notwithstanding the fact that many of the alleged violations of the antitrust acts had long been accepted trade practices and in no sense violations of any law under state regulation, the Attorney-General of the United States, following a comprehensive field investigation, determined to initiate antitrust action. Indictments were returned against the South-Eastern Underwriters Association charging violation of the antitrust acts.[33] The charges in the indictment are stated thus:

Count 1 of the indictment avers that appellees conspired to fix and maintain arbitrary and non-competitive premium rates on fire insurance in restraint of the interstate trade and commerce described in the indictment (R. 10–12), and Count 2 charges that appellees conspired to monopolize trade and commerce in fire insurance in order to exclude others from engaging in the sale of fire insurance in interstate commerce (R. 13–14).

Each count charges that the conspiracy consisted of agreements among appellees to sell insurance and to pay commissions to agents at rates fixed by the Association, and to withhold reinsurance facilities from, and prevent access to such facilities by, non-members of the Association (R. 11, 13). It is further charged that appellees have threatened to refuse and actually refuse to deal with any agency which represents companies not members of the Association, have agreed to disparage and have disparaged the services and facilities of such companies, and have threatened to boycott and withhold patronage from persons purchasing fire insurance from such companies (R. 11, 13–14). It is averred that appellees have agreed to maintain and have maintained inspection and rating

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[32] Memorandum of Frank H. Elmore, Jr., Special Assistant to the Attorney-General, to Assistant Attorney-General Arnold, dated January 21, 1942.

[33] The Federal Grand Jury, on November 20, 1942, returned an indictment against the South-Eastern Underwriters Association, an unincorporated association composed of stock fire insurance companies doing business in Alabama, Florida, Virginia, North Carolina, South Carolina and Georgia; nearly two hundred member stock fire insurance companies; and twenty-seven individuals who are officers or members of the executive committees of the association.

bureaus and local boards in order to police, strengthen and further the agreements and practices described.[34]

The government contended that the insurance business was, in fact, commerce and that the conduct of the companies "plainly is proscribed by the literal language" of the Sherman Act.[35] It was contended that there was nothing to evidence a legislative intention to exempt insurance from its terms. The case was argued in the District Court of Georgia.

Consternation Springs from S.E.U.A. Action. The possibility that the S.E.U.A. case might decide against the insurance companies gave rise to great uncertainty both to those engaged in the business of insurance and to the legal profession. That there was logic behind the contention that insurance is interstate commerce could not be denied. It became more and more apparent that there was a very real possibility that the court would upset the long standing legal precedent. If it did this and made the business of insurance subject to the Sherman Act, there was grave concern upon the part of the insurance industry, and the legal profession as well, that certain cooperative activities long deemed essential for the successful conduct of the business, or in any case not deemed to be contrary to any statute, would now be held to constitute violations of the law. The fear that confusion might develop was very real,[36] nor was it lacking in legal precedent. For example, in the Deer Lodge case it was stated:

> We have already pointed out that if insurance is commerce and becomes interstate commerce whenever it is between citizens of different states, then all control over it is taken from the States and the legislative regulations which this court has heretofore sustained must be declared invalid.[37]

In contrast to the contention of the insurance companies that insurance is not commerce, the government contended that, while insurance because of its nature was in fact commerce, this did not preclude regulation of the business by the states, so far as that regulation

[34] "Brief for the United States" in the Supreme Court of the United States, *United States of America* v. *South-Eastern Underwriters Association*, pp. 3–4.

[35] *Ibid.*, p. 9.

[36] For example, it was said: "If you disobey the State laws you will be punished, and if you obey them, you will suffer the eternal damnation of the Sherman Anti-Trust Act." See Gontrum, J. B., *"Paul* v. *Virginia*—A Review of the Past and Look into the Future," American Bar Association, Section of Insurance Law, *Report of Proceedings at the Chicago Meeting 1943–1944*, p. 15.

[37] *New York Life Ins. Co.* v. *Deer Lodge County*, 231 U.S. 495 (1913).

was not incompatible with federal statutes. The argument was presented in the brief, thus:

> Appellees' argument that a reversal of this Court's past doctrine would nullify the present state regulatory systems is irrelevant and exaggerated. Even if insurance is commerce within the meaning of the Constitution, the states are not precluded from taxing or regulating it, and the insurance decisions stand legitimately for the proposition that in the absence of a conflicting federal law, state regulation of the industry is appropriate. Nor is there merit in the contention that application of the Sherman Act will result in any general destruction of state regulatory systems. Furthermore, none of the state laws go so far as to authorize or justify the coercive tactics charged to appellees in this case.[88]

The government's argument was sustained by the S.E.U.A. decision, as will presently be noticed.

The Paul Doctrine Is Reversed. The district court in writing the decision was influenced by the powerful precedent of the insurance cases and upheld the Paul doctrine thus:

> Counsel for the Government concede that in the numerous decisions cited the Supreme Court has held that the business of insurance is not commerce, yet, strangely enough, ask this Court to rule directly to the contrary. Of course, the Supreme Court decisions must be followed by this Court. . . . .
>
> If there is to be any overruling of the long line of clear and thoroughly considered decisions of the Supreme Court, acquiesced in for seventy-five years by Congress and administrative agencies, it will have to be done by the Supreme Court itself, or by Congress.[89]

The case was appealed to the Supreme Court; and after hearing the arguments in January, 1944, the court handed down the momentous decision five months later. The insurance companies in their argument on appeal relied heavily upon the precedent of the "insurance cases." They also gave emphasis to the fact that, though previous efforts had been made to secure enactment of federal regulatory bills by Congress, these bills had always failed of passage. The contention was also made that, because the Department of Justice had hitherto not applied the Sherman Act to the business of insurance, the conclusion could be drawn that the department had not considered the act applicable. It was argued, as well, that the application of the antitrust laws to the business of insurance would bring about unrestricted competition, make co-operative rate mak-

[88] "Brief for the United States" in the Supreme Court of the United States, *United States of America* v. *South-Eastern Underwriters Association et al.*, p. 11.

[89] *United States* v. *South-Eastern Underwriters Association et al.*, 51 F. Supp. 712 (1943).

ing no longer legal, and bring about the unhealthy situation that followed the passage of the anti-compact laws. The arguments submitted by the companies in support of a dismissal of the indictment are summarized thus:

1. This Court should not repudiate its uniform decisions of the past 75 years that fire insurance is not commerce.
2. Congress has accepted and approved the Supreme Court decisions that fire insurance is not commerce.
3. The States have curtailed competition in fire insurance in reliance upon the Supreme Court decisions that fire insurance is not commerce.
4. This Court will unsettle the law applicable to fire insurance and expose defendants to retroactive criminal penalties if it now holds that fire insurance is commerce.
5. The power of Congress to regulate fire insurance is not here at issue.[40]

In writing the opinion of the court in the S.E.U.A. case, Justice Black points out first that the generalization that "the business of insurance is not commerce and can never be conducted so as to constitute commerce among the states is inconsistent with many of the decisions of the Court." He points out that a contract of insurance considered as a thing apart from negotiation and execution does not of itself constitute interstate commerce. It is stated, however, that it does not follow that the court may not examine the entire transaction, of which the insurance contract is but a part, in order to determine whether there may be a chain of events which becomes interstate commerce. It is then pointed out:

Not only, then, may transactions be commerce though non-commercial; they may be commerce though illegal and sporadic, and though they do not utilize common carriers or concern the flow of anything more tangible than electrons and information. These activities having already been held to constitute interstate commerce, and persons engaged in them therefore having been held subject to Federal regulation, it would indeed be difficult now to hold that no activities of any insurance company can ever constitute interstate commerce so as to make it subject to such regulation; activities which, as part of the conduct of a legitimate and useful commercial enterprise may embrace integrated operations in many states and involve the transmission of great quantities of money, documents, and communications across dozens of State lines.[41]

In contrast to the foregoing, it is interesting to note the attitude

[40] "Brief for the Appellees" in the Supreme Court of the United States, *United States* v. *South-Eastern Underwriters Association et al.*, p. 7.

[41] *United States* v. *South-Eastern Underwriters Association et al.*, 64 Sup. Ct. 1162 (1944).

of Mr. Justice Jackson, who in the minority opinion more closely approached the expectations both of the insurance business and the legal profession. In a dissent in part he states:

The principles of decision that I would apply to this case are neither novel nor complicated and may be shortly put:

1. As a *matter of fact,* modern insurance business, as usually conducted, is commerce; and where it is conducted across state lines, it is *in fact* interstate commerce.

2. In contemplation of law, however, insurance has acquired an established doctrinal status not based on present-day facts. For constitutional purposes a fiction has been established, and long acted upon by the Court, the states, and the Congress, that insurance is not commerce.

3. So long as Congress acquiesces, this Court should adhere to this carefully considered and frequently reiterated rule which sustains the traditional regulation and taxation of insurance companies by the states.[42]

It was the contention of Mr. Justice Jackson that the long line of decisions should be allowed to stand and, even though insurance was recognized not logically to be commerce, that the body of law built around the fiction should not be disturbed by a court decision but only disturbed if Congress should take positive action. Chief Justice Stone, dissenting, states:

The numerous and unvarying decisions of this court that "insurance is not commerce" have never denied that acts of interstate commerce may be incidental to the business of writing and performing contracts of insurance, or that those incidental acts are subject to the commerce power. Our decisions on this subject have uniformly rested on the ground that the formation of an insurance contract, even though it insures against risk of loss to property located in other states or moving in interstate commerce, is not interstate commerce, and that although the incidents of interstate communication and transportation which often attend the formation and performance of an insurance contract are interstate commerce, they do not serve to render the business of insurance itself interstate commerce.[43]

The Chief Justice then adds:

If the business of entering into insurance contracts is not interstate commerce, it seems plain that agreements to fix premium rates, or other restraints on competition in entering into such contracts, are not violations of the Sherman Act. As we have often had occasion to point out, the restraints prohibited by the Sherman Act are of competition in the marketing of goods or services whenever the competition occurs in or affects interstate commerce in those goods and services. See *Apex Hosiery Co.* v. *Leader,* 310 U.S. 469–501; 60 S. Ct. 982, 993–96;

[42] *Ibid.,* Dissent in part by Jackson, 64 Sup. Ct. 1191.
[43] *Ibid.,* Dissent by Stone, 64 Sup. Ct. 1181.

84 L.Ed. 1311; 128 A.L.R. 1044, and cases cited. The contract of insurance does not undertake to supply or market goods or services and there is no suggestion that policies of insurance when issued are articles of commerce or that after their issue they are sold in the market as such, or, if they were, that the formation of the contract would itself be interstate commerce. . . . .[44]

The majority opinion of the court was otherwise. The opinion stated:

No commercial enterprise of any kind which conducts its activities across State lines has been held to be wholly beyond the regulatory power of Congress under the commerce clause. We cannot make an exception of the business of insurance.[45]

Thus insurance became subject to federal regulation. When the Paul doctrine was finally overturned, the legal profession, because of its profound respect for *stare decisis,* and the insurance business, because of its confirmed conviction that the regulation of insurance was inseparably associated with state regulation, were both shocked. There were many, however, who had given painstaking and thoughtful study to the subject and who believed that if the doctrine were ever tested in a case involving a federal statute the Paul dictum would not stand.[46] This conclusion proved to be correct.[47]

[44] *Ibid.,* 1183.

[45] *United States* v. *South-Eastern Underwriters Association et al.,* 64 Sup. Ct. 1162 (1944).

[46] See, for example, Professor Ralph Blanchard in "The Lawyer and Insurance" in an address before the American Bar Association, December, 1945: "Sooner or later insurance would probably have been declared to be interstate commerce by the Supreme Court in any event, but the present situation can be traced directly to outmoded practices which were fostered by the divided authority of the individual states." Again Professor Blanchard in an address before the Fire and Casualty Conference of Ohio State University on government regulation of insurance evidences the same opinion thus: "These decisions [S.E.U.A. and the *Polish Alliance* cases] astonished and shocked a considerable group of insurance men, though students of the law both in and outside the business have prophesied that the Court would declare insurance to be commerce, if a Federal question were squarely presented."

[47] The S.E.U.A. case was precedent shattering in two respects. Not only did it reverse a doctrine of seventy-five years' standing, but in addition to this the decision was rendered by a minority of the full court. This reversed a practice of the court instituted by Chief Justice Marshall in 1834. Cf. Marshall, C. J. (5 Peters 122). "The practice of this court is not (except in cases of absolute necessity) to deliver any judgment in the cases where constitutional cases are involved, unless four judges concur in opinion, thus, making the decision that of a majority of the whole court." Prior to S.E.U.A. since 1879 a previous decision of the Supreme Court has never been overruled by less than a majority of the full court. In the S.E.U.A. case the decision was rendered by four justices (Black, Douglas, Murphy, and Rutledge). Three justices dissented (Chief Justice Stone, with Frankfurter and Jackson). Two justices did not sit (Robertson and Reed).

The decision of the court certainly reversed the theory of insurance regulation.

Polish National Alliance Case. This case was decided on the same day that the decision in the S.E.U.A. case was handed down. In this case the *Polish National Alliance* v. *National Labor Relations Board,*[48] the court was called upon to decide whether the Polish Alliance, a fraternal insurance organization, was subject to the National Labor Relations Act and to the jurisdiction of the National Labor Relations Board.

The National Labor Relations Act applies to labor disputes "affecting commerce." It was not necessary, therefore, in this case to determine that "insurance is commerce" in order to bring the business of insurance within the scope of the act. The decision, however, recognized the interstate nature of the activities of the business of insurance when it stated:

> This summary of the activities of Alliance and of the methods and facilities for their pursuit amply shows the web of money-making transactions woven across many state lines. An effective strike against such a business enterprise, centered in Chicago but radiating from it all over the country, would as a practical matter certainly burden and obstruct the means of transmission and communication across these state lines. Stoppage or disruption of the work in Chicago involves interruptions in the steady stream, into and out of Illinois, of bills, notices, and policies, the payments of commissions, the making of loans on policies, the insertion and circulation of advertising material in newspapers, and its dissemination over the radio. The effect of such interruptions on commerce is unmistakable. The load of interstate communication and transportation services is lessened, cash necessary for interstate business becomes unavailable, the business, interstate, of newspapers and radio stations suffer. Nor is this all. Alliance, it appears, plays a credit role in interstate industries, railroads, and other public utilities. In 1941, it acquired securities in an amount in excess of $11,000,000, and sold or redeemed securities costing more than $7,500,000. Financial transactions of this magnitude cannot be impeded even temporarily without affecting to an extent not negligible the interstate enterprises in which the large assets of Alliance are invested.[49]

The decision then goes on to state:

There is a contention the court did not, in fact, reverse itself. It is stated that in the "insurance cases" the facts related to state legislation and the court determined the right of states to regulate under the police power. The S.E.U.A. case, it is stated, did not overrule the Paul decision but limited the rights of the states when there was a conflict between state and federal statutes. Prior to S.E.U.A., the precise question of the right of Congress to regulate had never been presented to the court.

[48] 64 Sup. Ct. 1196 (1944). Contrary to the situation in the S.E.U.A. case, the decision of the court by Justices Frankfurter and Black in the Polish Alliance case was unanimous. Mr. Justice Roberts did not sit. Decisions were written by Justices Frankfurter and Black.

[49] 64 Sup. Ct. 1198.

To hold that Congress could not deem the activities here in question to affect what men of practical affairs would call commerce, and to deem them related to such commerce merely by gossamer threads and not by solid ties, would be to disrespect the judgment that is open to men who have the constitutional power and responsibility to legislate for the Nation.[50]

Though the decision did not determine insurance to be commerce, it did establish that Congress may regulate "the interstate financial operations of the business of insurance just as it established that it may regulate their labor relations."[51] This is based on the principle already established that, when the conduct of an enterprise affects commerce among the states, then the enterprise, even though not in itself interstate commerce, is subject to regulation.[52] On the basis of the Polish Alliance decision it follows, therefore, that the activities of an insurance company, if they affect the commerce of the nation, are subject to federal regulation. The effect upon commerce does not have to be direct; it is only necessary that the activity substantially affect interstate commerce.[53]

Sphere of State Regulation. The authority of the state to regulate its internal affairs under the police power has never been delegated to the federal government. Congress has been granted the express power "to regulate commerce with foreign nations and among the several states, and with the Indian tribes."[54] Since the decision in the S.E.U.A. case has the effect of determining insurance to be interstate commerce, the question immediately presented itself to the insurance industry as to what extent the states had been divested of authority to make laws for the regulation of insurance. Mr. Justice Black in his opinion points out:

In all cases in which the Court has relied upon the proposition that "the business of insurance is not commerce," its attention was focused on the validity of state statutes—the extent to which the Commerce Clause automatically deprived states of the power to regulate the insurance business. Since Congress had at no time attempted to control the insurance business, invalidation of the state statutes would practically have been equivalent to granting insurance companies engaged in interstate activities a blanket license to operate without legal restraint. As early as 1866 the insurance trade, though still in its infancy, was subject to widespread abuses. To meet the imperative need for correction of these abuses

[50] *Ibid.*, 1200.

[51] Powell, *op. cit.*, p. 976.

[52] *Wickard* v. *Filburn*, 317 U.S. 111 (1942).

[53] Berke, N. R., "A Legal Economic Discussion of the 'S.E.U.A.' and 'Polish Alliance' Cases," *Insurance Law Journal*, July, 1944, p. 397.

[54] Article I, sec. 8, clause 3, of the Constitution.

the various state legislatures, including that of Virginia, passed regulatory legislation. *Paul* v. *Virginia* upheld one of Virginia's statutes. To uphold insurance laws of other states, including tax laws, *Paul* v. *Virginia's* generalization and reasoning have been consistently adhered to.[55]

Even prior to the enactment of federal legislation delegating authority to the states, it should be assumed from the language of the decision that it was not the intention of the court to take away from the states the right to regulate insurance. This conclusion is supported by the following:

> It is settled that, for Constitutional purposes, certain activities of a business may be intrastate and therefore subject to state control, while other activities of the same business may be interstate and therefore subject to federal regulation. And there is a wide range of business and other activities which, though subject to federal regulation, are so intimately related to local welfare that, in the absence of Congressional action, they may be regulated or taxed by the states. In marking out these activities the primary test applied by the Court is not the mechanical one of whether the particular activity affected by the state regulation is part of interstate commerce, but rather whether, in each case, the competing demands of the state and national interests involved can be accommodated. And the fact that particular phases of an interstate business or activity have long been regulated or taxed by states has been recognized as a strong reason why, in the continued absence of conflicting Congressional action, the state regulatory and tax laws should be declared valid.[56]

From the foregoing, it follows that the federal law applies to interstate commerce and, as well, that state law likewise applies to interstate insurance until the federal government elects to exercise its power to legislate in that field. State legislation on the statute books not contrary to federal legislation was, therefore, not nullified by the decision in the S.E.U.A. case.

Public Law 15. When the S.E.U.A. decision was pending, a strong effort was made to nullify the effect of a possible adverse decision. This was to be accomplished by exempting the business of insurance by statute from the application of the federal antitrust statutes. The Bailey–Van Nuys bill, introduced into the Congress, affirmed that it was the intent of Congress that the regulation of insurance remain within the control of the several states and that the Sherman and Clayton Anti-Trust Acts be not applicable to the business of insurance. The bill passed the House but failed of passage

[55] *United States* v. *South-Eastern Underwriters Association et al.*, 64 Sup. Ct. 1162 (1944).

[56] *Ibid.*, at 1171.

in the Senate. The scope of the Bailey–Van Nuys bill was considered by a thoughtful group in the insurance business to be too far reaching.[57] A committee of the National Association of Insurance Commissioners, in co-operation with insurance representatives, drew up a bill which they recommended to Congress. This bill, unlike the Bailey–Van Nuys bill which would exempt the insurance business from the operation of the federal antitrust statutes, recommended rather that the business be given a moratorium in which to readjust itself to the federal statutes. This bill became the basis for the statute ultimately enacted as Public Law 15. The act is very short. After declaring that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of Congress was not to be construed to impose any barrier to the regulation or taxation of such business by the several states, the applicability to the business of insurance is stated in the following sections:

Sec. 2. (*a*) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(*b*) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after January 1, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

Sec. 3 (*a*) Until January 1, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, and the Act of June 19, 1936, known as the Robinson-Patman Anti-discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

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[57] On September 20, 1943, the Walter-Hancock Bill (H.R. 3270) was introduced in the House of Representatives; and a duplicate bill (S. 1362), known as the Bailey–Van Nuys Bill, was introduced in the Senate the next day. These bills provided: "Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That nothing contained in the Act of July 2, 1890, as amended, known as the Sherman Act, or the Act of October 15, 1914, as amended, known as the Clayton Act, shall be construed to apply to the business of insurance or to acts in the conduct of that business or in any wise to impair the regulation of that business by the several states."

(*b*) Nothing contained in this Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

Sec. 4. Nothing contained in this Act shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.[68]

It is to be noted that the law provides for the regulation and taxation of insurance by the several states. The Sherman Act, the Clayton Act, and the Federal Trade Commission Act are made applicable to the business of insurance after January 1, 1948, "to the extent that such business is not regulated by State law," with the exception that the Sherman Act is applicable to "any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." It is expected that in the meantime, state regulatory statutes will be enacted which will bring the state statutes in line with the federal antitrust statutes. It is for the reason that the period up to 1948 is given for readjustment, that the law is referred to as the "moratorium law." In affixing his signature to the bill on March 9, 1945, President Roosevelt made the following statement:

I have given my approval to S. 340, the insurance bill, which passed the Congress last week. This bill grants the insurance business a moratorium from the application of the anti-trust laws and certain related statutes, except for agreements to boycott, coercion or intimidation, or acts of boycott, coercion, or intimidation, until January 1, 1948. The purpose of this moratorium period is to permit the States to make necessary readjustments in their laws with respect to insurance in order to bring them into conformity with the decision of the Supreme Court in the South-Eastern Underwriters Association case. After the moratorium period, the anti-trust laws and certain related statutes will be applicable in full force and effect to the business of insurance except to the extent that the States have assumed the responsibility, and are effectively performing that responsibility, for the regulation of whatever aspect of the insurance business may be involved. It is clear from the legislative history and the language of this act, that the Congress intended no grant of immunity for monopoly or for boycott, coercion or intimidation. Congress did not intend to permit private rate fixing, which the Anti-Trust Act forbids, but was willing to permit actual regulation of rates by affirmative action of the States.

The bill is eminently fair to the States. It provides an opportunity for the orderly correction of abuses which have existed in the insurance business and

[68] Public Law 15, c. 20 (79th Cong., 1st Sess.).

preserves the right of the States to regulate in a manner consonant with the Supreme Court's interpretation of the anti-trust laws.[59]

With the passage of Public Law 15, Congress evidenced its intent. Under the terms of the act it delegated to the several states the regulation of the insurance business. It is definitely clear, however, that Congress intended the Sherman, Clayton, Robinson-Patman, and the Federal Trade Commission Acts to apply to insurance. This has no other effect than to emphasize that by leaving regulation to the states it is intended that the regulation of the states will be positive. It has been emphasized that the states may not nullify the enforcement of federal statutes by enacting state statutes that are negative or ineffectual.[60]

The Doctrine of Congressional "Consent" and "Silence." It is now established that Congress has power to enable the states to take action with respect to interstate commerce which otherwise they could not readily take.[61] This power has been established by legislative and judicial decisions and has been extended from time to time in its application to different phases of interstate commerce. It is known as the "Doctrine of Congressional Consent" or sometimes the "Doctrine of Congressional Permission." Whenever litigation has developed touching upon this power, the power has been sustained.[62] Under this doctrine, Congress definitely has the right

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[59] Text of President Roosevelt's statement accompanying his signature of insurance bill on March 9, 1945.

[60] For a definitive account of the impact of the S.E.U.A. decision on the business of insurance and a legislative plan for a state system of regulation, see Sawyer, E. W., *Insurance as Inter-State Commerce* (New York: McGraw-Hill Book Co., Inc., 1945).

Following the enactment of Public Law 15, the National Association of Insurance Commissioners immediately held meetings with a view to making recommendations to the various state legislatures to bring insurance regulation in conformity with federal requirements. At the same time, the insurance industry through its various divisions organized the All-Industry Committee. Represented on the All-Industry Committee were: the National Board of Fire Underwriters, the American Mutual Alliance, the National Bureau of Casualty and Surety Underwriters, the Association of Casualty and Surety Executives, the National Association of Insurance Agents, the National Association of Mutual Insurance Agents, the National Association of Insurance Brokers, the National Association of Independent Insurance Companies, the American Life Convention, and the Life Insurance Association of America. This committee had for its purpose the provision of legislation that would be acceptable to the insurance industry and at the same time meet the requirements of the Congress. Both organizations have prepared model bills.

[61] *International Shoe* v. *Washington,* 90 L. Ed. 109, and *Southern Pacific* v. *Arizona,* 89 L. Ed. 1469.

[62] Dowling, N. T., and Patterson, E. W., *Memorandum for Committee of American Life Convention and Life Insurance Association of America, November 29, 1944.* Sub-

to delegate the supervision of insurance to the various states. This, in effect, is what it has accomplished in the passage of Public Law 15. Whether Congress will ultimately take more definite control of the insurance business into its own hands is a matter for the future determination of that body. It is definitely established that Congress may not relinquish to the states its exclusive power over interstate commerce conferred upon it by the Constitution, though it may delegate those powers or enlarge the powers of the states. Presumably, whatever future action Congress may take will be largely dependent upon how successfully, in the eyes of Congress, the states fulfill the regulatory obligations which have now been or may in the future be delegated to them.

Closely allied to the "Doctrine of Congressional Consent" is the so-called "Doctrine of Silence of Congress." Under this doctrine it is held that, when Congress does not legislate upon a question, state enactments will govern. However, this doctrine will not extend to permit a state to pass legislation that will impose a direct burden upon interstate commerce. This follows regardless of whether or not there is any direct federal regulation bearing upon the subject.[63] The state does not have the right to restrain that which in the absence of federal regulation should be free.

State Regulation as Interference with Interstate Transactions. It was natural that almost immediately the jurisdiction of the states would be challenged in their regulatory capacity. The first case to be tried in a federal court involving the power of the states over insurance, in the light of the ruling that insurance is interstate commerce, resulted in the decision that the state statutes involved in the suit in question were not vitiated in any way by the decision of the Supreme Court in the S.E.U.A. case.[64]

In the action in question instituted by the First National Benefits Society, a nonprofit corporation organized under the laws of the state of Arizona, a complaint for an injunction was filed against

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ject: (1) effect of the South-Eastern Underwriters decision on state tax laws, and (2) power of Congress to permit such laws to continue in operation.

[63] Partridge, C., "States' Rights and Insurance after S.E.U.A.," *Insurance Law Journal*, May, 1945, p. 270.

[64] *First National Benefits Society* v. *Garrison et al.*, 58 F. Supp. 972 (1945). The decision was written by Mr. Justice O'Connor, who was formerly Comptroller of the Currency. It has been termed "a most able opinion that is a capsule education in federal constitutional law" (*Insurance Law Journal*, February, 1945, p. 75).

Maynard Garrison, Insurance Commissioner of the state of California and others, in which it was alleged:

That plaintiff has upon many occasions received inquiries from persons residing in the State of California in regard to its insurance policies or benefit certificates and has thereupon sent its representatives, also members of the said Society, to call upon persons making such inquiries; that applications have been signed by the said residents of California and thereupon forwarded to the home office for acceptance or rejection; that upon acceptance of the said applications the policies are issued at the home office at Phoenix, Arizona, and mailed directly to the insured with notice to pay all premiums at the home office; . . . . that upon many occasions the defendant, Maynard Garrison, acting through his deputies, under claim of right but actually without right and in violation of the commerce clause of the Constitution of the United States, and repugnant to the Fourteenth Amendment of the Constitution of the United States, has interfered with the said representatives and has threatened them with prosecution if they persisted in aiding in such transactions.[65]

The society contended that it was qualified to do a life insurance business in Arizona and that there was no provision for the admission of any such company in the state of California on any basis whatsoever. The association contended that it was entitled to transact an insurance business in California and relied for its contention upon the S.E.U.A. decision. It contended that it had this right without complying with the laws of the state of California. Referring to the reversal of the Paul doctrine by the S.E.U.A. decision that held insurance to be commerce, and where conducted across state lines to be interstate commerce, the association, basing its argument upon the effects of this decision, contended:

It is then, the effect which this decision may have upon the right of the States to regulate this field of interstate commerce which is involved in this case. . . . .

This case is not, as counsel says, "an attempt by a foreign insurance company to transact business in the State of California without meeting the standards of safety set by that State," but it is the presentation of the question which everyone connected with the insurance business now knows must be presented to the Supreme Court, and that is can the State of California or any State reach out across its state lines and regulate the corporate structure, the actuarial standard, and even the bookkeeping basis as well as complete regulation of such foreign companies' business in every state in the Union, for the privilege of transacting an interstate business with the citizens of California or the state attempting to so regulate, even though such business may be small in comparison to the company's business elsewhere.

This case does not present the question as to whether or not the laws of

[65] *Ibid.*

California will be nullified but as to whether the State of California can nullify the laws of every other state in the Union if the companies organized in those states are to do an interstate business with the citizens of that state.

We are not contending, as counsel seems to intimate, that all state legislation is nullified.

This entire matter revolves around the question as to whether or not the plaintiff must obtain the consent of the State of California to transact an interstate business with its citizens when that consent requires the conforming of its entire business, which is spread over every state in the Union, to the regulations of the State of California. Many regulatory measures could be enacted by a State for the protection of its citizens, without the right to require a foreign corporation to obtain the state's consent to transact an interstate business with its citizens. . . . .[66]

In a lengthy decision, citing the authorities dealing with the exercise of police power by the state, on the one hand, and the authority of Congress to exercise its powers to legislate on interstate commerce under the commerce clause of the United States Constitution, on the other, the court held that local regulation remained effective until suspended by federal regulation. On this point the court stated:

The power to regulate commerce among the states is a unit, but if particular subjects within its operation do not require the application of a general or uniform system, the states may legislate in regard to them with a view to local needs and circumstances until Congress otherwise directs, but the power thus exercised by the states is not identical in its extent with the power to regulate commerce among the states. The power to pass laws in respect to internal commerce, inspection laws, quarantine and health laws, and laws in relation to bridges, ferries, and highways belongs to the class of power pertaining to locality, essential to local intercommunication, to the protection, the safety, and the welfare of society, originally necessarily belonging to, and upon the adoption of the Constitution reserved by, the states, except so far as falling within the scope of a power confided to the general government. Where the subject matter requires a uniform system as between the states, the power controlling it is vested exclusively in Congress and cannot be encroached upon by the state; but where in relation to the subject matter different rules may be suitable for different localities, the states may exercise powers which, though they may be said to partake of the nature of the power granted to the Federal government, are strictly not such, but are simply local powers, which have full operation until or unless circumscribed by the action of Congress.[67]

The court held that until Congress legislates in the matter of insurance, and to that extent only, state statutes enacted under the police power remain in full force and effect. The court held that if

[66] *Ibid.*
[67] *Ibid.*

Congress legislates on insurance, as it may now do because insurance has been determined to be interstate commerce, state laws will fall, but only to the extent they are supplemented by federal legislation. In the meantime, state statutes remain in full force and effect.[68] The case was appealed from the District Court of the United States to the United States Circuit Court of Appeals and, relying upon the Supreme Court decision in *Robertson* v. *People of the State of California,*[68] the decision was affirmed.[69] It therefore follows that state laws regulating insurance, notwithstanding its nature as interstate commerce, remain in full force in the absence of conflicting federal legislation.

The Indivisible Stream Theory. In holding the business of insurance to be commerce, and, as ordinarily carried on by most insurers, interstate commerce, the S.E.U.A. decision would indicate that even though some of the operations of the insurance companies might be construed to be commerce and not interstate commerce, the word "indivisible" in the decision leads to the conclusion that any insurance company operating in more than its home state is engaged in interstate commerce. The significant passage from the decision follows:

> This business is not separated into 48 distinct territorial compartments which function in isolation from each other. Interrelationship, interdependence, and integration of activities in all the States in which they operate are practical aspects of the insurance companies' methods of doing business. . . . . The result is a continuous and indivisible stream of intercourse among the States composed of collections of premiums, payments of policy obligations, and the countless documents and communications which are essential to the negotiation and execution of policy contracts. Individual policyholders living in many different States who own policies in a single company have their separate interests blended in one assembled fund of assets upon which all are equally dependent for payment of their policies. The decisions which that company makes at its home office

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[68] 66 S.Ct. 1160. The *Robertson* case was tried in the California state courts and appealed to the United States Supreme Court. The case was decided by that Court June 3, 1946, and it was in reliance upon this decision that the judgment of the District Court in the *First National Benefits Society* case was affirmed. In the Supreme Court decision it was stated: "It would be idle to require licensing of insurance agents, in order to secure honesty and competence, yet to place no restraint upon the kind of insurance to be sold or the kinds of companies allowed to sell it, and then to cover their representatives with their immunity. This could only result in placing domestic and qualifying foreign insurers at great disadvantage and eventually in nullifying all controls unless or until Congress should take over the regulation." 66 S.Ct. at 1169.

[69] *First National Benefits Society* v. *Garrison et al.,* 155 Fed. 2d 522.

—the risks it insures, the premiums it charges, the investments it makes, the losses it pays—concerns not just the people of the State where the home office happens to be located. They concern people living far beyond the boundaries of the State.[70]

The "indivisible stream of intercourse" to which reference is made has the effect of eliminating any possibility of an insurance company segregating its business into two categories: one, interstate and, the other, intrastate. To be sure, there are a few small companies, whose activities are on a purely local basis, that are carrying on a commercial activity without interstate implications. However, the commercial business of insurance, as ordinarily carried on in the United States today, is, beyond question, interstate commerce in all its activities and, because of this, is subject to federal regulation and all federal statutes applicable to interstate commerce.

State Tax Program Valid. While Public Law 15 provided that no act of Congress should be construed "to invalidate, impair, or supersede" state taxes levied upon the business of insurance, nevertheless it was feared that, when a tax was levied by a state on a foreign company for an amount in excess of that levied on a domestic company, such a tax might be held to be a burden on interstate commerce.

A case to test the validity of the so-called "discriminatory laws" was brought in the state of South Carolina by the Prudential Insurance Company. It was contended that, while the states should continue to regulate and tax insurance, such regulation and taxation should be of a nature not to impose an undue burden on interstate commerce and not to discriminate against interstate business. The company argued that tax laws which discriminate between the foreign and domestic companies amounted to discrimination and, likewise, imposed an undue burden upon interstate commerce. The court in a unanimous decision, however, held that the South Carolina law could in no way be construed to be a violation of the commerce clause of the federal Constitution. It pointed out that it was the intent of Congress in passing Public Law 15 to support existing and future state systems for the regulation and taxing of the insurance business. Recognizing the right of states to tax domestic and foreign insurance companies at a different rate, the court stated:

[70] *United States* v. *South-Eastern Underwriters Association et al.*, 64 Sup. Ct. 1162 (1944).

Congress must have had full knowledge of the nationwide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the taxes exacted.[71]

The decision handed down in the South Carolina case establishes the position of the court as holding that discriminatory taxes favoring domestic companies are not a burden on interstate commerce and, hence, not in contradiction to the commerce clause of the Constitution. Upon appeal to the Supreme Court the decision of the district court was upheld.[72]

Regulation Must Be Reasonable. In the regulation of insurance, regulation must be reasonable, and the decisions of the regulatory authorities cannot be arbitrary. It is a basic principle in the law that, when a state, in the exercise of its police power, undertakes to suppress what it regards as a public evil, it may adopt whatever reasonable measures it deems necessary to accomplish the end.[73] Reasonableness has been held to be the test of police power.[74]

State regulatory officials may not make arbitrary distinctions between individuals and companies, even where wide discretion is delegated to that officer by statute. To undertake discrimination through the agency of regulation clashes with constitutional guarantees.

The different states have set up various standards as a basis for granting or refusing an applicant a license to carry on the business of insurance. The right of the state legislature to enact laws limiting the field of insurance solicitation to those who measure up to certain requirements of dependency and trustworthiness is no longer questioned. Regulation may not only control solicitors and others in immediate contact with the public but may also extend to the companies themselves. It is well established that the requirement of a license, or certificate of authority, to do business is permissible as one of the most efficient means of securing proper regulation.

Attempts have been made through the agency of licensing to exercise some control over the persons who should be permitted to carry on an insurance business. For example, in the field of life insurance, efforts were made to prevent the licensing of part-time

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[71] *Prudential Insurance Company* v. *Benjamin,* 90 Law Ed. 1023 (1945).

[72] *Prudential Insurance Company* v. *Benjamin,* 66 S.Ct. 1141 (1946). Three states—Indiana, Kansas, and South Carolina—have held premium tax laws of their respective states to be valid notwithstanding differences in favor of domestic companies.

[73] *Purity Extract & Tonic Co.* v. *Lynch,* 226 U.S. 192 (1912).

[74] *Sproles* v. *Binford,* 286 U.S. 374 (1932).

agents as well as to prevent the licensing of lawyers, clergymen, and others who would carry on insurance work only as a side line. Such efforts have been held to be unconstitutional as an abridgement of the right of a citizen to follow any lawful occupation. The courts have repeatedly held that the constitutional guarantee would be worth little if citizens could, without compensation, be deprived of the rights to engage in particular occupations or if arbitrary restrictions could be set up that amount to the same thing. It has been stated that, under the mere guise of police regulation, personal rights and private property cannot be arbitrarily invaded.[75] Such limitations as the state may place upon restricting the right of a citizen to engage in the business of insurance can be exercised only in accordance with the police powers of the state for the protection of health, morals, or general welfare.[76]

Commissions and Profits in the Regulatory Structure. One of the most controversial subjects in the field of insurance is the matter of the compensation paid to the insurance agent. It is unquestionably true that the agent's compensation is an important factor in insurance costs, and in any rating structure the agent's remuneration will have to be justified on the basis of the service he renders. On this point, there is already established a legal precedent:

> The agent's compensation being a percentage of the premium, bears a direct relation to the rate charged the insured. The percentage commonly allowed is so large that it is a vital element in the rate structure and may seriously affect the adequacy of the rate. Excessive commissions may result in an unreasonably high rate level or in impairment of the financial stability of the insurer.[77]

Increasing emphasis has been given in recent years to the requirement that insurance agents be something more than order-takers. The insurance business is a highly technical one, and the service that a qualified agent is able to render to the policyholder in arranging his insurance program and assisting in the adjustment of losses is a very real one indeed. The business of insurance is coming increas-

[75] *Pennsylvania Coal Co.* v. *Mahon,* 260 U.S. 393 (1922).

[76] A New York case, while not dealing with the subject of insurance, expresses the general rule thus: "A statute passed pursuant to the police power should be reasonable. Its real purpose must be to protect the public health, morals, or general welfare. A statute cannot under the guise of police power, but really to effect some purpose not within such power, arbitrarily interfere with a person or property right." *People* v. *Ringe,* 90 N.E. 451; 97 N.Y. 143 (1910). See also *Liggett (Louis K.) Co.* v. *Baldridge,* 278 U. S. 105 (1928), and *Pennsylvania Coal Co.* v. *Mahon,* 260 U. S. 393 (1922).

[77] *O'Gorman & Young* v. *Hartford Fire Insurance Co.,* 282 U.S. 251 (1930).

ingly to recognize the fact that a flat percentage commission on a large policy is entirely out of line with the same percentage commission on a small policy, if the extent of the service rendered is the writing and the delivery of the policy. On the other hand, the agent properly qualified to service a large policy is not overpaid if the commission is correspondingly large. The weakness in the system of commissions lies in the fact that it is possible for incompetent agents to secure the sizable commissions without having the ability to render the service to which the policyholder is presumed to be entitled.

On the other hand, present commission rates represent a long-established custom. Aggressive insurance agents point out that increasing costs of doing business have not been reflected in increasing remuneration. The reasonable solution to the problem will probably be found in an acceleration of the trend toward higher agency qualification laws to the end that incompetence will be eliminated and that the commission allowed by the regulatory bodies will amply compensate the well-trained and competent agent. Failure to provide adequate compensation will have an adverse effect upon the American agency system. The continuation of a system that permits the payment of substantial commissions without the rendering of a commensurate service is bound, in the long run, to have an equally unfavorable reaction.

Another point which has been the occasion of some thought and considerable controversy in the framing of regulatory legislation has been the matter of profits. Stock insurance companies are privately owned business organizations, and in the process of regulation it is at once apparent that rates must give consideration to the profit element. Primarily, rates must be fixed at a point that will provide adequate funds to pay for losses and to carry on the business. Over and above that, they must provide remuneration in the way of profit sufficient to attract capital to the business.

Considerable difference of opinion has arisen as to whether legislation covering insurance regulation should make provision in the rates for "profit" or "underwriting profit." There is a wide difference. Many insurance companies often experience a year in which their insurance operations show an underwriting loss. They may actually, however, show a profit for the year because from investment income they not only make up the underwriting loss but have a balance for the profit column. There is a school of thought that

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contends that the investment income of the insurance industry should not be used as a measure for determining rates. They contend that rates should be predicated upon loss experience, plus such other items as are necessary to carry on the business including a margin for profit. Others contend that a reasonable investment profit may be anticipated from the funds of the companies and that rates should be predicated upon a basis that will permit the company to make a profit but not necessarily an underwriting profit.[78]

Present Status of Regulation. As a result of the decision in the S.E.U.A. case, the theory of insurance regulation has undergone a complete change. As a result of the passage of Public Law 15, the mechanics of regulation will, for the time being at least, probably remain unchanged; that is, the regulation of the insurance business will remain in the hands of the states. However, because of the status of insurance as commerce, and because, where interstate, it is subject to federal regulation, it is expected that existing state statutes will be modified to bring state regulatory programs in line with the intent of Congress as evidenced by the enactment of Public Law 15. While details may change, and in numerous instances definitely will, the major regulatory functions appear to be in state hands.

While a substantial and articulate section of the insurance industry has definitely evidenced an opinion favoring the continued regulation of the business of insurance by the states, the opinion is by no means unanimous. Over the years, there had always been those who have felt that the uniformity of federal supervision would be an asset to the business and have definitely favored such regulation. It is conceivably possible, in the period in which state regulation following the enactment of Public Law 15 may be said to be on trial, that any marked failure in meeting with the congressional intent may be the occasion for those favoring federal regulation to evidence themselves more positively. In any case, since Congress now has jurisdiction over insurance, so far as it is interstate, it may at any time withdraw from the states the powers it had delegated and make control and regulation of the business a federal function.

In the meantime, state-rating organizations may continue to

[78] The so-called "All-Industry bills" recommended to the National Association of Insurance Commissioners called for a "fair margin for underwriting profit." It was contended that without the provision for underwriting profit unwise regulation, in making unwarranted assumptions as to investment earnings, could endanger the solvency of the companies.

function on a co-operative basis. Such organizations may not function as a monopoly; but co-operative rate making, so long as the rates are determined by state authority to be "reasonable, adequate, and not unfairly discriminatory," is held not to be contrary to the federal intent.

The right of the states to tax insurance remains unchanged even where preferential consideration is given to companies of the home state. This appears not to be a burden upon interstate commerce. This leaves the state taxing power untouched, though a state conceivably could carry taxing to a point where the federal authority might intervene.

There has been no development that would indicate any change in the right of the state to determine the standards of admission to do an insurance business within its borders; nor is there any indication that statutes governing assets, liquidation of companies, uniformity of practices, investments, licensing of agents and brokers, statement requirements, and the like are in any sense changed.

Specifically, Congress has declared that the continued regulation and taxation by the several states of the business of insurance is in the public interest. It has further declared that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states; and further, no act of Congress is to be so construed as to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance. This leaves the mechanics of regulation with the states.

There is one great difference in regulation as it exists now, in contrast to the situation prior to the S.E.U.A. decision and Public Law 15. Existing state laws may not nullify the Sherman Act, the Clayton Act, the Federal Trade Commission Act, the Robinson-Patman Antidiscrimination Act, the National Labor Relations Act, and the Fair Labor Standards Act; nor may they enact laws that will be in conflict with them. Pending or proposed state legislation has, as one of its primary objects, the reconciling of any differences that may be found to exist.

The fact that insurance departments have been set up in the interests of both companies and insureds, and that a safeguard in the form of regulatory statutes has been established, has tended to build

up and justify the confidence of the public in the institution of insurance. While it may be stated that it is hardly proper to attribute the high standards and business ethics of the great insurance companies to regulation (nor has the regulation up to now in all states been said to be equally effective), it may be said in all fairness that regulation has been an important factor in protecting the companies doing business on an equitable basis from unfair competition, as well as guaranteeing to insureds that weak or insolvent companies or companies offering inequitable contracts will not be permitted to function. In the new regulatory trend, there is every reason to believe that the insurance business, as well as the public it serves, will, in the long run, be decidedly benefited.

FOR REVIEW

1. Insurance has long been subject to regulation. In your opinion, is it logically a proper subject for regulation? The business is carried on by privately owned companies, and there is no right on the part of the public to demand and receive their services. They compete for business just as do automobile companies, lumber producers, and other privately owned business enterprises. Should not competition be the sole regulatory force?
2. Discuss the extent to which you feel insurance should be regulated by the states.
3. It has been stated, regardless of the S.E.U.A. decision, that Congress could probably have exerted control over the business of insurance on the ground, not that insurance was commerce, but that it *affected commerce*. Discuss this point.
4. A substantial section of the insurance industry, prior to the decision in the S.E.U.A. case, predicted chaos in the industry if the decision should be such as to reverse the Paul doctrine. It has been suggested that the enactment of Public Law 15 averted the overturning of the accepted system of state regulation and thereby avoided the chaos that was predicted. What is your opinion on this point?
5. If a law should be passed in Congress, similar in intent to the Sherman Act but so worded as to nullify much of the regulatory legislation passed by state legislatures (in view of the fact that insurance is now commerce), which laws would prevail, the federal or the state?
6. It has been stated that the Sherman Act stands between industry and government control. Discuss the logic which warrants such a conclusion.
7. It has been stated that Public Law 15 has a dual purpose. Explain.
8. Public Law 15 is said to provide a moratorium for the insurance business from the operation of the Sherman Act. There is an exception, however. Explain.
9. Explain the operation of Public Law 15 as it applies to (*a*) the National

Labor Relations Act, (*b*) the Fair Standards Act of 1938, and (*c*) the Merchant Marine Act of 1920.

10. There are two basic questions that were presented to the Court in the S.E.U.A. case. Name them.
11. In the famous Deer Lodge case an attempt was made to nullify discriminatory state tax laws by establishing the business of life insurance to be interstate commerce. Leading counsel on the brief and on the argument was Dean Roscoe Pound. In the brief it was contended that "in the case at bar the essential point is, not that the insurance business is the source of the transactions in question, but that the state is obstructing business that is wholly interstate business." In the light of recent Supreme Court decisions, in your opinion, would the insurance company have accomplished its purpose even though it had succeeded in securing an opinion from the court that life insurance was in fact interstate commerce?
12. In the brief for the government in the S.E.U.A. case it is contended that the statement "Insurance is not commerce" was designed to strengthen regulation. How can this be?
13. Describe a type of state law which would conflict with the Sherman Act.
14. The Brief for Appellees in the S.E.U.A. case indicates that state experience is now hostile to competition. To quote from the brief: "Their experience has taught the States that unlimited competition in fire insurance—as distinguished from other businesses—leads to: (1) insolvency of insurers which in turn injures the assured public since they will not only have paid out their money for nothing but, worse, will have relied in ignorance on a worthless indemnification; (2) competition going to greater extremes than in other businesses; (3) increased fire losses due to failure to take proper precautions to minimize hazards; (4) discrimination in favor of the influential assured whose business is sought rather than the average assured; and (5) a greater concentration of wealth and power in the larger, at the expense of the smaller, companies." Discuss briefly each of these points.

Chapter VII

INSURANCE CARRIERS

CARRIER Contact with the Insured. Only in the case of carriers who restrict their lines to a local territory do the insureds in the usual course of business come in contact with company officers. In the greater number of cases the contact between insured and carrier is made through an agent who is paid by the company he represents. Carriers are termed either direct-writing or agency companies, depending upon their production plan. Direct-writing companies employ field representatives, who contact the insured and service the policies. Agency companies appoint local representatives in the communities in which they do business and pay the agents a commission on all business which they originate. Under the agency system a local agency may represent a group of companies, and the multiple-line agencies write business for a number of companies in several or all of the various insurance groups. Companies are able to write on a nation-wide basis and secure a diversified classification of risks economically through the utilization of local agents. The agent is a company representative, and the authority under which he operates is delegated through the medium of an agency contract.

In the larger communities the insurance broker plays an important part in the business of insurance. The broker has been termed an anomaly in that he serves the insured yet is paid by the insurer. The broker is a middleman between the insured and the company agent. In the early days when the broker made his first appearance in the insurance business, it was contended that he rendered no service since he did for the insured only what the company officers were ready and willing to do. Men of ability and integrity made their livelihood from this occupation, and their value to the insurance company was finally recognized and admitted. By informing themselves of rates, forms, and other technical features of the business they became increasingly useful to the insured, and since they secured their remuneration in the form of a commission from the company, their service to the insured had the additional attraction of being free. Brokers are now recognized intermediaries between the company and the insured.

There is sometimes some confusion on the part of uninformed insureds dealing with a broker because they do not differentiate between an insurance broker and an agent. The insurance agent is acting under specific and delegated authority from his company and is authorized to bind his company within the limits of his delegated authority. The broker, on the other hand, has no such authority and in most jurisdictions is recognized as the agent of the insured. This has been modified in some states by statutes which specifically provide that for the purposes of collecting premiums and delivering policies the broker is an agent of the company but for all other purposes is agent of the insured.

Part of the confusion concerning the status of the broker grows out of the fact that, while the service he renders is designed primarily for the insured, he receives no compensation from the insured but is remunerated by the company with whom he places the business on a commission basis. The mental attitude of the broker as representative of the insured has thus been admirably expressed:

> There is no such thing as buying adequate business insurance *ready-made.* This is one of the many reasons why every corporation should use a competent insurance broker. The broker is essentially a buyer—not a salesman. He is unbiased and independent. He represents only the insured, sits on his side of the desk, helps him negotiate contracts and settle claims—at all times giving *impartial* advice. His compensation is a brokerage paid by the seller—the insurance company.[1]

Ordinarily, the broker places the business he develops through a local agency, and the commission allowed by the insurance company on the policies is divided between the broker and the agent.

Classification of Insurance Carriers. Insurance carriers are divided broadly into six groups, as follows: (1) stock companies; (2) mutuals; (3) Lloyd's; (4) reciprocals or inter-insurers; (5) state insurers; and (6) self-insurers. Stock companies, Lloyd's, and sometimes state insurers are essentially non-co-operative and capitalistic in their operations; the insureds have no ownership in the funds out of which losses are to be paid. The others are mutual in their nature. Certain types of state insurance are included in this latter classification.

Stock Companies. The stock companies operating in the United

[1] From an advertisement of Johnson & Higgins, Insurance Brokers, *Business Week,* July 26, 1941, p. 6

States at present are corporations organized either in the United States (domestic) or corporations that are organized abroad (foreign). In the United States a corporation organized to write insurance under the laws of a particular state is considered a domestic company by that state but is usually termed "foreign" by all other states. The term "alien" is generally applied to those companies incorporated in some foreign country. The stock insurance companies have for their purpose the conduct of one or several of the different classes of the insurance business. Strict laws govern their operation; and they are obliged to satisfy the designated authorities as to their capital, reserve fund, assets, and investments. The contracts (policies) they issue are written for a definitely stated consideration (premium), and so far as the insured is concerned the transaction has no interest for him beyond indemnification in the event he suffers loss. He receives no benefit (dividend) from the earnings of the company and pays no assessment or additional premium if losses exceed income.

Stock companies are organized as profit-making ventures. The capital subscribed by the stockholders serves as a fund, in addition to premium payments, out of which losses are to be paid. Additions made to the surplus serve the same purpose. Stock insurance carriers assume risks with the profit element in view, and fix their rates accordingly.

A recent development in the field of stock insurance has been the exploration of the possibilities on the part of stock companies of writing participating policies in the field of property insurance. Special participating policies have been written by stock life insurance companies affording policyholders much the same type of contract as that offered by the mutual companies, with the difference that control of the stock companies rested with the stockholders. Stock companies in the property field have heretofore not made a practice of writing participating policies. Recent steps by some of the more important companies have been taken to secure legislative authority to share earnings with policyholders without changing to a mutual basis.

Rigorous supervision is maintained by the various states over stock companies admitted to do business within their borders. The state sets high standards for capital and reserve requirements prerequisite to granting a domestic charter or a license for foreign corporations.

The facilities of stock companies are world-wide in their scope and

are being continually adjusted to meet changing conditions. In the United States stock companies generally write their business through local agents, allowing them a commission on the business. The agents, in turn, act as insurance advisers to their insureds.

The absence of any form of contingent liability in stock insurance guarantees the policyholder that his first cost is the final cost. Advocates of mutual insurance contend that stock companies tend to overemphasize the importance of this point. The question cannot be decided arbitrarily.

Mutuals. A mutual insurance company is a corporation owned, operated, and controlled by its policyholders. It is organized under general laws for the purpose of providing insurance for its policyholders at cost. Every policyholder is a member of the company. There are no stockholders. The mutual policyholder-members elect the board of directors. The board elects the executive officers who actually manage the company. The mutual corporation assumes the hazards of its policyholder-members. As a consideration for the assumption of this risk, each policyholder-member, except in the case of certain farm mutuals, pays or agrees to pay in advance a premium and, where their contracts so provide, a specified assessment where premium contributions are inadequate. Where the premiums in a given period are more than adequate to meet losses and expense, the excess is returned to the policyholder.

Mutual insurance divides itself into numerous classes. Some of the local farm mutuals, for example, confine their activities to a limited area, collecting no advance premiums and levying assessments at stated intervals. A number of farm mutuals, however, operate on the advance premium basis and cover a considerable territory. General-writing mutual insurance companies do business on the advance premium basis, operating over a wide area, many of them extending their activities throughout the country. Their methods of operation vary; but they can be divided into three general groups, the division being based upon the method of handling premiums. Companies in the first group, exemplified by organizations such as the Factory Mutuals, require assureds to deposit with them large premiums, estimated from past experience to be in excess of all loss requirements. At the end of the policy period, deductions are made for expenses and actual losses paid, and the balance returned to the assured. Companies in the second group base their rates upon the

stock companies' published tariffs. The premium charged is equal to or less than the stock tariff; and any balance above expenses, losses, and reserve requirements and a reasonable contribution to surplus is returned to the assured as a dividend. Mutuals in the third group charge rates substantially lower than those used by the stock companies. These rates reflect the experience of the company, and no dividend return is contemplated.

Advance premium mutual insurance companies issue two types of policies: assessable and nonassessable. Up to a certain point of financial stability, they must provide for limited assessment liability. Assessment liability is usually limited to one additional premium. The companies comprising the Factory Mutual group have an assessment liability equal to five times the deposit premium. This group has never levied an assessment. Policyholders whose contracts so provide are subject to assessment to meet losses and expenses when the resources of the company have been exhausted. All states permit the issuance of nonassessable policies. The general standard for writing nonassessable policies requires a mutual to be possessed of the finances of stock companies transacting the same kinds of business. A majority of the advance premium mutual companies issue nonassessable policies.

The laws under which advance premium mutuals operate set up minimum financial requirements for organization or admission. Requirements necessary for the mutual plan of doing business are set out in detail. Generally these laws require mutual companies to comply with the same reserve, investment, policy form, and other regulatory laws applicable to stock companies. As in the case of stock companies, they are subject to rigorous supervision by the various state insurance departments.

Class Mutuals. Certain mutuals confine their operations to selected risks of a definite class and hence are called "class mutuals." There are companies which insure primarily certain kinds of businesses such as miiling and grain operations; others insure lumber and allied lines, hardware and kindred risks, drugs, and numerous other classifications. These organizations have a store of specialized information for their respective fields. The insurance of factories is one of the important fields covered by class mutuals.

Farm Mutuals. There are said to be nearly 2,000 farmers' mutuals now doing business; and, with $12,704,156,258 of insurance in force,

they insure about three-fourths of the insurable farm property. These companies are growing in number and size. They find an important place in every rural community.

Farm mutual contracts are written with both a limited and an unlimited liability policy. A member who belongs to a company in which liability is unlimited binds himself to pay his pro rata share of all losses and legitimate expenses of the company. The unlimited liability for assessment has caused some concern to many who fear that a serious catastrophe might involve them in assessments greater than they could meet. It is said, on the other hand, that because farm risks are so scattered, a farmers' mutual with a reasonable number of risks is comparatively free from the catastrophe hazard, unless perhaps in a frontier community, where prairie or forest fires are a menace. About seven-tenths of the farm mutuals operate with the unlimited assessment plan.

Factory Mutuals. An important group of insurance carriers in the mutual group base their operations on the belief that fire prevention should be the first and basic aim in any effort to secure low-cost insurance. The first company in the group, later to develop into the important Factory Mutual System, was organized in 1835 to insure manufacturing properties, and from the beginning gave practical application to the prevention idea.[2]

As the idea grew, a technical staff of trained engineers studied the problem of prevention, and a laboratory for research and testing was maintained. Slow-burning construction was advocated; special hazards were studied with a view to providing safeguards; and when new fire prevention developments appeared, their adoption was encouraged. It was this group that was largely responsible for the adoption of the automatic sprinkler.

[2] The Factory Mutual Fire Insurance System is the outgrowth of the idea of a New England manufacturer who interested other manufacturers in a plan to share losses on their factories on a mutual basis. The originators of the plan undertook a careful study of the causes of fire, and through the inauguration of a program of prevention members of the group were able materially to reduce the cost of their insurance protection. A mutual company was formed and later other similar companies were organized. As the size of lines increased, insurance was distributed among the different companies of the group. Companies co-operate in engineering and inspection work, adjustment of losses, or other phases of the business with resultant efficiency and economy.

There are monthly meetings of company officers at which matters of common interest are considered. The group is known as the Conference, and its functions are concerned primarily with inspections, though it reviews other matters of interest. The findings of the Conference are mainly advisory, each company being free in the conduct of its own affairs.

The Factory Mutuals limit their commitments to the highest grade of protected properties and insist that their insureds meet their standards before acceptance. More recently the companies have shown a tendency to enlarge the scope of their operations and, instead of limiting them strictly to factories, have written other classes of risk, including hospitals, churches, and schools.[8]

The cost of administration in the Factory Mutual System includes the cost of inspection and engineering services. Because of the cost of inspections, surveys, consultations, and conferences pending improvement of the risk, the insurance plan, and other services rendered, companies in the group do not solicit small risks.

Policies of the Factory Mutual System are broad in their scope and especially adapted to the needs of their insureds. Full insurance coverage, amounting ordinarily to 90 per cent of the value of the property above the foundations, is usually required, though it is not the practice to make this requirement a part of the contract. Thus, while it is desired that full insurance be carried, a failure to keep insurance up to changing values, when an increase in costs goes unnoticed, does not penalize the insured.

Companies in the Factory Mutual System make their contracts in their home offices. Manufacturers in states other than the home state of the company concerned are considered as having come to that state for insurance. On this basis it has been held that the company does business in its own state, and accordingly there exists no need for formally entering other states. It is the policy of the Factory Mutuals, however, to become licensed in all states where a sufficient volume of business is developed.

Mutual Casualty Insurance. While there are a great many substantial mutual companies writing casualty insurance, the unfor-

[8] The procedure for placing insurance with the Factory Mutuals requires the filing of an application with one of the companies of the group by the prospective insured. The company then undertakes an examination of the property, and if it is found to conform to requirements a detailed survey is undertaken. Frequently the services of trained experts are necessary to complete a survey and if necessary make recommendations for necessary improvements to bring the property up to standard. This work is done at no cost to the applicant. When the findings of the inspection department are sent to the owner of the property, he may then proceed, if he wishes, to effect the recommended changes. If the owner elects to comply with the recommendations, insurance may be written when the improvements have reached a stage approved by the company. When the risk is ready for insurance, the company that has been supervising the preliminary survey distributes the insurance among the companies of the group. The company placing the insurance checks all policies of associated companies, and when all are found ready and in order they are sent by this company to the insured.

tunate experiences of a few ventures in the field have been publicized in such a manner as to be misleading.

A group of the leading companies in the field have formed the National Association of Mutual Casualty Companies, which has set up high standards that must be met by any company qualifying for membership. These companies have accumulated substantial reserves, which they guard by reinsuring large lines. Most of the companies in this group issue nonassessable policies. Where the policies contain an assessment clause, it is ordinarily limited in amount to one annual premium. It is contended, however, that because of the policy of the members of the association to reinsure excess losses, the integrity of the company's surplus is maintained and the probability of an assessment is extremely remote, if not a practical impossibility.

Member companies of the National Association of Mutual Casualty Companies write nearly all forms of casualty insurance, including accident, the various automobile coverages, burglary, theft, hold-up, fidelity, all the important liability coverages, plate glass, various property damage coverages, and workmen's compensation.

Lloyd's (London). One of the most famous institutions for the insurance of risks is located in London and still bears the name of the coffeehouse in which it originated. In the process of development, Lloyd's has become a great corporation. But as a corporation it neither subscribes to policies of insurance nor directly issues them. Insurance is still written by individual underwriters, who are themselves members of the corporation but who in their undertakings of insurance sign "each for himself and not for another."

Membership in the Corporation of Lloyd's has been compared with membership in the New York Stock Exchange. The Exchange sets up standards with which its members must comply. Yet a purchase of a security from a member is a transaction between that member and his customer. So with Lloyd's. It is itself a permanent organization made up of an ever changing body of members, who are in the first place elected to membership and whose places are filled following death or resignation.

Until recent years the Corporation exercised little actual control over its members, and they operated with great freedom, limited only by the opinion and regard of the other members. Recent developments have resulted in the adoption of numerous regulatory measures, such, for example, as limiting a member's commitments to a

ratio to his capital deemed proper by the Corporation. There is now also a reserve fund requirement.

A deposit of a sum in excess of £10,000,000 by the members of this Corporation is required to safeguard the interests of policyholders, and it is required that all current premiums be segregated under a deed of trust as a fund out of which claims may be paid. The great pride taken by the members in the enviable record of the institution is a safeguard, as is the searching and far-reaching annual audit.

There are no insurance companies in Lloyd's, nor any connected as underwriters in the Lloyd's organization. Nor are there any devices of any sort designed to limit the liability of any insurer, whose every penny stands squarely behind any risk he may assume. If the underwriter whose name appears on a policy is unable to pay a claim, the insured has no claim whatever against either Lloyd's or the other underwriters for more than the share of the loss they themselves specifically assumed. There is, however, a further element of protection in the guarantee fund and in the guarantee policies that members take out insuring one another, as well as in the fact that other members would in all probability make good the losses of a bankrupt member to maintain the prestige of their institution. There is ample precedent for this last-mentioned procedure, though there is no legal obligation whatsoever.

There are approximately 1,400 underwriting members of Lloyd's, who form themselves into underwriting syndicates. There are about 140 syndicates, with a membership varying from 6 to as many as 100 in each. The syndicate is operated by an agent, who is also frequently its organizer. Each member is expected to have assets of not less than $500,000; and, while he assumes the risks to which he is committed, business is not carried on by him personally but in his name. The agent is the one who actually does the underwriting and commits his "names" to the risk.

Again, when a policy is desired through Lloyd's, business is transacted not with the underwriters or syndicate agents who underwrite for their names but through a broker. With an adequate description of the risk, the broker circulates among the underwriters, offering the line. Each underwriter who wishes signs a slip carried by the broker, indicating the amount for which he will commit his syndicate. When the slip is full, that is, when the broker has obtained enough signers so that the amounts they assume will total the required insurance,

Lloyd's Policy Signing Office draws up and issues the policy. This document, however, is not signed by the Corporation but by the individuals, who must themselves pay in the event of loss. The Corporation of Lloyd's itself participates in no direct way in the business of insurance. Its functions are purely to supervise transactions and guard the reputation of the institution.

Lloyd's (American). In the United States there have developed groups of individuals and individual voluntary partnerships which have entered the business of underwriting risks upon a plan based to some degree upon that followed by Lloyd's of London, and from the similarity these organizations have been termed Lloyd's Groups.

In the American groups, each member ordinarily holds himself liable for a given amount upon any desired number of risks, but as a general rule these are definitely limited by a specified maximum. The strict regulations governing membership, deposits, and audits of the London Lloyd's are not a requisite of the ordinary American group. Each organization depends upon the financial strength of its individual members; and the name Lloyd's carries with it no particular significance as to financial position, integrity, and past reputation so far as the American groups are concerned. While it is true that some of these groups have operated with success for some time in this country, others, lacking the stricter regulation exercised abroad, have operated with indifferent success and, in certain instances, because of inadequate resources or questionable practices, have brought the name under a cloud.

Confusion has sometimes existed in the minds of insureds who have associated the name Lloyd's with the original organization in London and, relying upon the strength, reputation, and credit of that organization, have not understood that the American Lloyd's and the London organization have no connection.

From the insured's point of view, the chief problem presented by the Lloyd's Groups lies in the difficulty of knowing the financial position of each subscriber to the policy. Again, since each subscriber is liable only for the part of the risk that he specifically assumes, in the event of disagreement the insured must seek out each individual underwriter and sue him personally for his share of the loss.

Reciprocals. The reciprocal, or inter-insurance, association is a development of mutual insurance. There is no capital independent of the assets of the policyholders out of which losses are to be paid.

Each policyholder under this form of insurance contract is insured by all of the others; and he, on the other hand, insures them, ordinarily to a stipulated amount. While the plan is effectively mutual in its operation, it is not in the true sense mutual, because the individual subscribers in their capacity as underwriters assume their liability as individuals; and the form of agreement most generally used provides that this liability shall be several and not joint. The funds of one subscriber, therefore, may not be diverted to liquidate claims of other subscribers, and the stability of an exchange or the financial responsibility behind a given policy can be determined only by ascertaining the financial responsibility of each individual underwriter committed on the risk.

Reciprocal exchanges do not incorporate, nor do they operate as partnerships. The policyholders, or subscribers, appoint a manager to whom is entrusted the responsibility of carrying on the business; he derives his authority from a power of attorney and is in turn known as an "attorney-in-fact." The power of attorney is the basis of the underwriting agreement made by the subscribers.

Reciprocal insurance is quite distinctly an American development. A half-century ago a group of New York businessmen, believing fire insurance rates on their property to be too high, met to devise a co-operative form of fire insurance that would eliminate the profit element from the contract, as well as the losses from the least desirable risks, thereby providing themselves with insurance coverage at cost.

The original plan provided for the building-up of a fund through the annual payment into it by each member of an amount equal to his annual premium before joining the group. This fund was to be increased each year at the same rate until a maximum of five times the annual premium was built up. Finally, if the losses of members at any time exceeded the total reserve, each member of the group was obligated to contribute to the insurance fund an amount proportioned upon his annual premium, but not in excess of ten times that premium. Thus, if a member of the group paid a premium each year of $500, his liability for assessment was limited to $5,000. The business for the group was carried on by a person authorized by power of attorney.

As the reciprocal idea took hold, reciprocal fire insurance exchanges were developed with standardized contracts. With the development of this form of business and the organization of more

exchanges, there was organized a group of large exchanges, known as Associated Reciprocal Exchanges.

Until 1914, there were fewer than fifteen reciprocal exchanges for the purpose of handling fire insurance, and only one for other risks. With the development of the automobile, however, casualty and automobile reciprocal exchanges began to multiply, so that within a decade there were over a hundred. Those in control of the older and more conservatively operated reciprocals have been concerned with the tendency of enterprising attorneys-in-fact, who, while adopting the reciprocal idea, have failed to incorporate in their plan certain features of safety to be found in the older organizations and believed to be essential to a sound reciprocal exchange.

In the fire group, the Associated Reciprocal Exchanges include Individual Underwriters, the oldest organization of its kind, and the New York Reciprocal Underwriters, at present the largest reciprocal exchange, as well as three other important organizations.

In this group a very important element of control over the attorney-in-fact is provided by an advisory committee. In addition to controlling the investment and custody of all funds over the amount required to operate the exchange, this committee has complete control over the manager through its power to replace the attorney-in-fact by a majority vote of its members. Friends of this form of insurance coverage point out that, since the members of the advisory committee are the chief officers of large corporations whose entire assets are largely, if not entirely, under the protection of the policies of the exchange, the committee men have interests identical with the insureds. Intimate information concerning current developments is furnished the committee through monthly reports and regular audits, in addition to frequent meetings. The control exercised by the committee is considered a vital element in the plan.

In a reciprocal that maintains no engineering organization, the compensation of the attorney-in-fact represents the entire cost of carrying on the business. The powers of the attorney-in-fact, as conferred by a power of attorney, signed by all who join the group, are sometimes very broad. Such limitations as are provided are often not made the subject of inquiry by prospective insureds, and it sometimes happens that an insured under a reciprocal contract is unaware of the extent of the rights he has conferred and the obligations he has assumed.

The form of organization, investing almost absolute power in the hands of a single individual, has tempted unscrupulous promoters to utilize reciprocals to their own ends. When the limit of liability is not carefully provided for and understood, a reciprocal in the hands of an unscrupulous attorney might prove to be disastrous to the insureds. Several organizations have been disrupted because of corruption.

To warn property owners of the danger of signing a document granting powers of attorney to parties unknown to them would seem almost unnecessary. Experience, however, indicates the need of such a warning. Documents of this type should always be submitted to a competent attorney familiar with this work, with the request that he advise upon the indirect as well as the direct liabilities involved.

State Insurance. When a state or nation performs the functions of an insurance carrier, the insurance so provided is termed "state insurance." In this form of insurance enterprise the government manages the project and assumes the liability for payment of claims. State insurance falls into two general categories. The first embraces those projects of a social nature, such as the provision of old age pensions, unemployment insurance, and maternity benefits. The second classification includes the writing of insurance risks by the state in competition with privately owned insurance carriers.

In competition with private enterprise, perhaps the most progress has been made in this country by state insurers in the field of workmen's compensation. That this is in effect a form of social insurance may to a degree account for the willingness of some states to participate. Compensation insurance, so written by the state, is usually carried on through a state fund. In the beginning the state sets up a fund which is augmented by premium payments and drawn upon to settle losses. Any profit remaining after the settlement of claims is returned to the policyholders. State funds of this type are in their essence mutual insurance carriers operated by the state. Some states have made for themselves a monopoly of the compensation business, while others have entered the field as free and open competitors of privately owned and operated carriers.

The operation of state funds has met with varying degrees of success. In some instances they have functioned to the entire satisfaction of all parties concerned; in others there has been some question as to

their efficiency, while in some cases the experience has been decidedly unsatisfactory. Indicative of the difficulties involved, it has been pointed out that when competition is lacking there is a tendency toward inefficiency; and when competition is permitted, the governmental insurance office is hardly in a position to hold its own in the race because it lacks the business organization and trained staff of the well-established companies. State insurance carriers, moreover, are frequently obliged to assume risks that a privately operated company would scarcely consider. A final difficulty or deterrent factor to state insurance, considered by many to be of great importance, is to be found in the possibility of insurance projects becoming involved in political upheavals.

Self-Insurance. The plan by which an individual or concern sets up a private fund out of which to pay losses is termed "self-insurance." Where self-insurance can be successfully carried out, there is no doubt that it furnishes the least expensive of all the possible forms. The fund, as it accumulates, belongs to the insured, and he can invest it as he may deem prudent. He pays no commissions to agents, and other costs of operation are reduced to a minimum. No fees are required by the state. Benefits to be derived from care reflect directly to the owner-insurer.

If the owner of a large plant exposed to loss from a single fire cancels all outstanding insurance and instead deposits the annual insurance premium in a fund to meet losses as they occur, it is sometimes said that he is insuring himself. While such a procedure is ordinarily included in the category of self-insurance, it is not, as a matter of fact, insurance at all. There is no hedge, no shifting of the burden of risk. It is merely a gambling chance that no serious loss will occur—at least until the fund has reached a figure sufficient to meet it.

On the other hand, the setup of a chain store company with 1,000 retail outlets widely distributed geographically and much alike physically lends itself readily to a self-insurance plan. If an insurance premium is charged to each store, a fund sufficient to meet any loss that might occur at one time will rapidly accumulate. If each individual store of the chain has an extremely rapid stock turnover and low inventory, the loss to a single store will in no case be great. It will not in any instance be sizable enough to cripple or handicap the business seriously.

To institute a plan of self-insurance there must be a wide distribu-

tion of risks subject to the same hazards. The number of the greatest corporations in the country, with a wide distribution of property, who insure their property in commercial companies and forego the temptation to build up funds of their own even in the face of years of favorable experience affords evidence that but comparatively few organizations have an ideal setup for this plan. Certainly no company or individual with a limited number of risks should attempt to use it.

FOR REVIEW

1. What significance has the term "foreign" in the business of insurance?
2. In what class of insurance carriers is the major volume of insurance business written?
3. Distinguish between a stock and a mutual company.
4. Distinguish between (*a*) pure assessment mutuals, (*b*) deposit premium mutuals, (*c*) general writing mutuals.
5. Purchasers of mutual insurance frequently feel that all risk has been removed if the company in which they have insured their risk issues a policy with a limited assessment liability or with the assessment liability entirely eliminated. From the point of view of stock insurance, comment upon this position.
6. What was the underlying motive that prompted the organization of the Factory Mutuals?
7. In your opinion does state regulation of insurance companies guarantee security?
8. B's factory is valued at $200,000. Why is this risk not attractive to the Factory Mutuals?
9. Outline the plan of London Lloyd's.
10. Discuss the points of similarity and the differences between London Lloyd's and the American Lloyd's group.
11. Is London Lloyd's a mutual organization?
12. Is there any similarity between the Lloyd's plan and the reciprocal plan?
13. Discuss the shortcomings of a plan of self-insurance for a state and for a municipality.
14. In your opinion is self-insurance ever feasible? If so, under what circumstances?
15. The recent trend in legislation has been toward permitting mutual fire and casualty companies to issue policies without a contingent liabilty. This permits the issuing of nonassessable policies and eliminates one of the objections that many persons have had toward mutual insurance. In other words, it makes the cost of the insurance certain. Discuss this feature from the standpoint of insurance protection.

Chapter VIII

PHYSICAL AND MORAL HAZARDS

Risk Involves Numerous Hazards. "Risk," as an insurance term, finds frequent use to denote objective uncertainty. The term is likewise used with reference to the object to which the uncertainty attaches. We speak of the building insured as a good risk, a poor risk, a protected risk, or a fireproof risk. Obviously, one building differs from another. To determine the differences we must break down the total element of uncertainty, or risk, into its component factors.

Continuing with our example of a building, we shall see that a particular structure under consideration may be susceptible to fire because of its construction, its location, or the use to which it is put. The various factors which each contribute to the uncertainty are termed "hazards." Ordinarily, there are many separate hazards that contribute to the uncertainty that attaches to any particular object or person. The sum total of the hazards constitutes the risk.

Hazards Classified. A practice of the insurance business divides hazards into two major classifications. The first of these is termed "physical hazards" and includes within its scope everything relating to location, structure, occupancy, exposures, and the like. The term "moral hazards" is applied to those risks which have their inception in mental attitudes. Included in this second group are the hazards created by dishonesty, insanity, carelessness, indifference, and other causes psychological in nature.

The Forces of Nature. In any consideration of physical hazards we must first give due regard to those forces of nature that are beyond the control of man. While man may take steps to adjust himself to these forces, he has nevertheless thus far met with but partial success. Hence it is that today, as from the earliest times, calamities disastrous in their extent and nature are the results of windstorms, tornadoes, lightning, floods, and earthquakes.

Acts of God. The law has coined the term "acts of God" as applying to those causes of accident operating directly without human agency or intervention and not preventable by human foresight or care. Fires caused by lightning are so considered, but the element of

human agency is regarded as having intervened in fires otherwise caused. Storms or blizzards that prevent the moving of trains are considered acts of God, as are earthquakes, hurricanes, tempests, extraordinary floods, and freshets.

Since by definition an act of God is one that could not be prevented by care or foresight, human agency is powerless to do more than prepare as best it may to withstand the force of the disaster. It is to be noted, however, that catastrophes of a given type are more prevalent in certain areas of the globe than in others, and meteorological and geological informations enable us to determine those areas where a particular hazard is the greatest.

Earthquake Hazards in the United States. An earthquake is a trembling caused by vibrations of the crust of the earth.[1]

The danger from earthquakes in the United States is considered by geologists to be greatest in California, although the western Rocky Mountain area has a long history of chronic shocks. New England and New York have been comparatively free from earthquakes, and the geological foundations of New York and the important New England cities warrant no serious alarm for the safety of these cities.

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[1] Intensity of shocks is represented by means of numerals from 1 to 10, which have reference to the Rossi-Forrel scale of intensities. Number 1 represents a feeble shock felt by an experienced observer and recorded by a single seismograph, or by seismographs of the same model, while 10 represents a great disaster, disturbance of the strata, fissures in the ground, ruins. Intensity 5 of the scale refers to a moderate shock, felt generally by everyone and severe enough to disturb furniture and sometimes to ring bells. The remaining numbers represent intermediate intensities.

For the purpose of studying the distribution of earthquakes in the United States, the country has been divided into five regions, as follows: (1) Northeastern region, which includes New England and New York and which, in addition to having earthquake activity of its own, feels activity from Canada; (2) Eastern region, which includes the Appalachian activity, a continuation of that of New England, as well as a detached activity region along the coast; (3) Middle Western region, which embraces the territory between the region just described and the Rocky Mountains; (4) Western Mountain region, which extends roughly to the Pacific coast states; and (5) the Pacific Coast area, of which the severity of the shocks is well known.

Although in comparison with the rest of the earth, the tendency to earthquake in the United States is a little more than the average, each of these areas has a long history of shocks of Intensity 5 or more, and many of them of great severity. The more severe earthquakes tend to appear only at long intervals and in certain localities. This country, however, has experienced a number of earthquakes where an inspection of the surface geology would not indicate their probability.

During a period of nine years, from 1915 to 1923, the United States was affected by 955 earthquakes of perceptible intensity. The shocks were distributed over 42 states. Of the total, 594 were in California; 37 in Washington; 36 each in Nevada, Utah, and Vermont; 29 in Illinois; and 28 in Tennessee. No other state had over 20, and many had but 1 or 2.

The damage which an earthquake can do is obviously dependent upon the density of the population. The concentration of large populations in small areas, with the attendant high buildings and dependence upon a few main systems for food, water, and other necessities, creates a situation where an earthquake may wreak terrific havoc.

Ice a Menace to Navigation. Vessels crossing the Atlantic Ocean between Europe and the ports of North America, in addition to the problems of heavy weather, are confronted during certain seasons of the year with a serious hazard created by icebergs or extensive fields of compact ice. Floating in the lanes of navigation, ice has been the immediate cause of enormous losses of both property and life.

Icebergs are the broken projections of glaciers set adrift in the open sea. They are formed all the year round, though the greater number is set free during the summer season. They vary in size, but a berg 60 to 100 feet to the top of its walls, with pinnacles 200 to 250 feet in height and 500 yards long, is not at all unusual. These measurements represent the visible part of the berg, which is about one-eighth of the whole mass. Roughly speaking, then, there is about seven times as much of the berg under water as is seen above.

Icebergs frequently have outlying spurs under water and form the same menace to navigation as does a sunken reef or ledge. Vessels striking these concealed spurs have been seriously damaged when apparently they were entirely clear of the berg. Again, vessels have been damaged through the breaking-up or capsizing of icebergs. The melting of a berg sometimes results in a shift of its center of gravity to such a degree that the mass turns or shifts to an entirely new position. Frequently bergs float in the current in such a state of equilibrium that very little change is necessary to effect the overturn.

Icebergs appear in the greatest numbers along the Grand Banks of Newfoundland in the months of April, May, and June. Their location and movement vary from year to year, as they drift with the ocean currents; but in a well-defined area in the North Atlantic, where the Labrador Current and the Gulf Stream meet, they are likely to be found from April to June.

There is no satisfactory way of predicting the appearance or presence of ice in any given location where bergs may be expected. Weekly and monthly publications of the United States Hydrographic Office furnish information on the matter, and the various branch hydrographic offices receive from passing vessels and ice-patrol ships

daily reports of all obstructions to navigation, including those caused by ice.[2]

Tropical Cyclonic Storms. Cyclones are formed when winds are constantly drawn toward a center of low barometric pressure, around which they circulate.

Cyclonic storms are all alike in their essential characteristics, though different names are applied to them in different parts of the world. For example, we refer to the "hurricanes" that occur in the West Indies, and use the same term to apply to the storms in the region between Samoa and Australia. In the vicinity of the Philippines cyclonic storms are termed "typhoons," and in the Indian Ocean "cyclones."

While many cyclonic storms do little or no damage, the destruction wrought at times is terrific not only to shipping but to life and property when the storms cross the land, as they frequently do in the islands of the West Indies and in the Gulf and South Atlantic states.[3]

The Tornado. A manifestation of the cyclonic storm peculiar to the United States is the much dreaded tornado. A whirling wind; funnel-shaped, with the narrowing end toward the earth, and often but a few rods across the tip, the tornado is one of the most powerful and most destructive of all windstorms. Whirling at the terrific rate of from 400 to 500 miles an hour, the tornado at its tip destroys everything in its path. Tornadoes move across country, usually from east to west, at the rate of 30 to 50 miles an hour. The width of the path varies from a few feet to a third of a mile, with an average length of about 25 miles, though the length varies from 1 mile to 300 miles. The tornado usually precedes a thunderstorm and occurs most frequently from three to five o'clock in the afternoon, during the months of May, June, July, and August, though in the southern states it may be expected during any season of the year.[4]

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[2] The outstanding marine disaster attributable to floating ice was the sinking in 1912 of the liner "Titanic." Built for the White Star Line at a cost of approximately $7,500,000, this was the most complete and luxurious, as well as the safest, passenger ship ever built. On her maiden voyage to New York, at 11:45 P.M., April 10, she collided with an iceberg and sank two and a half hours later, with a loss of 815 passengers and 688 of her crew.

[3] The extent of loss may be estimated when it is recalled that the Galveston hurricane and tidal wave of 1900 cost 6,000 lives and destroyed property valued at more than $30,000,000. In the fall of 1926, the hurricane that ravaged Florida cost 370 lives and destroyed property amounting to $165,000,000.

[4] Millions of dollars in property are destroyed by these "twisters"; and when they strike thickly populated areas, loss of life is frequently high. Records show as many

Tornadoes most frequently appear in the Mississippi Valley and in the southern states, although with the exception of the Rocky Mountain region and the near vicinity of the Appalachian system, where they are almost entirely unknown, they may be expected in widely separated sections of the country. In a single year the record shows a distribution of 110 tornadoes in 23 states, extending from the Atlantic Ocean to Colorado and Montana. Notwithstanding this distribution, the region where tornadoes usually occur extends in a belt running from Texas to Ohio, often referred to as the Tornado Belt.

Other Wind Damage. Spectacular and destructive as are the violent storms of the tornado and hurricane type, damage from the winds is by no means confined to storms of disastrous proportions. Limbs from broken trees are frequently the cause of damage to buildings, automobiles, or other property. When valuable windows, such as are to be found in churches, are broken, the loss may be sizable.

In connection with crops, the wind sometimes becomes a destructive element. This is particularly so on the western plains, where there is almost continuous wind. An extreme temperature in conjunction with this wind may in a few hours wither crops to such a degree that the labor of a season is destroyed. Destructive storms have occurred in almost every state at one time or another.

Tidal Waves. It sometimes happens that the operation of natural forces involves the sea in such a way as to cause tremendous damage. Waves so caused may reach an extreme size and are then called "tidal waves." An upheaval in the ocean that causes a tidal wave may be the cause of damage thousands of miles away.[5]

Tidal waves are likewise caused by windstorms of the typhoon and hurricane type. The partial vacuum at the center of the storm seems to lift the level of the water. This change is scarcely perceptible at sea; but when the storm crosses the land, the bulge, moving with

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as 140 tornadoes in a single year. Loss of life in a single year has reached the impressive figure of 794 persons, with an accompanying property loss of approximately $47,000,000. Perhaps the outstanding disaster of this type occurred in Murpheysboro, Illinois, in March, 1925, with a loss of 742 lives and $16,500,000 in property. In May, 1896, a tornado struck the city of St. Louis, killing approximately 255 persons, with a property loss of about $55,000,000.

[5] The effect of the wave caused by the explosion of the volcano Krakatoa was felt as far away as 3,000 miles and caused the deaths of 30,000 people on the coasts of Java and Sumatra. Earthquakes, as well as volcanic eruptions, frequently cause tidal waves, particularly if the quakes occur under the ocean.

tremendous momentum, breaks, and the water rushes inland with great force. Tidal waves occasionally occur for which there seems to be no adequate explanation.

Thunderstorms and Lightning. In cities and built-up areas the damage from lightning is ordinarily not great, although sometimes it strikes high buildings and pinnacles, such as church spires. Because street railway, telephone, telegraph, and light wires all conduct electricity, they tend to ground lightning in the cities. The steel framework of skyscrapers also serves to ground electrical discharges and therefore tends to protect buildings of this type.

In rural communities, buildings located in the center of large plain areas furnish a high point toward which lightning is attracted. Houses, barns, silos, tall trees, and other unusually high points are frequently struck and damaged by resultant fire.[6]

Thunderstorms are abundant near the Equator and become increasingly rare toward the polar regions. In the United States, thunderstorms occur in great numbers along the Gulf of Mexico. Up the Atlantic Coast the number decreases fairly regularly with the distance from the Equator. Storms are prevalent in the Mississippi Valley, the area around New Orleans having the greatest number, with a steady decrease to the Great Lakes area. The West Coast is almost entirely free from thunderstorms, having hardly more than three a year.

Hail and Snow as Hazards. When hail accompanies thunderstorms, there is often great property loss, for hailstones ruin crops; and in the western part of the United States they have been known to kill small animals and poultry as well as such large animals as sheep, horses, and cattle. Hail, moreover, shatters glass roofs and windows. Hundreds of thousands of dollars' worth of property is not uncommonly destroyed in a single storm, and the annual loss from this cause often exceeds $10,000,000 and sometimes reaches $15,000,000.

The damage from snow is in most cases not great. Violent wind-driven snowstorms in the country are termed "blizzards." Some-

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[6] The annual farm property loss from lightning is estimated at a minimum of $20,000,000. The annual number of deaths on farms caused by lightning is placed between 400 and 500, with more than twice that number injured. The greatest damage of all, perhaps, in this country occurs in the forests. That more than 3,000 forest fires are caused in this country each year by lightning is said to be a conservative estimate, and the actual property loss thus caused can scarcely be estimated.

times they tie up transportation, cause the destruction of perishable shipments, and not infrequently the loss of life. In some locations heavy falls of snow make it necessary to brace buildings with flat roofs to prevent their collapse. Accumulations of heavy snow upon the branches of fruit and shade trees often break them down, and sliding snow from pitched roofs may injure pedestrians. Finally, melting snow on roofs is the cause of incalculable water damage to the interior of buildings.[7]

Floods. When more than a normal accumulation of water exists in a certain section of the surface of the earth and the natural drainage channels cannot take care of the surplus, an overflow, or flood, results. Floods are usually caused by too much rainfall in a given period, but in addition to the superabundance of rainfall there are frequently other contributing factors.[8]

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[7] While occasionally some startling disaster, such as the collapse in Washington, D.C., of the Knickerbocker Theatre, with a death list of 98 and a list of about 100 injured, invites attention to danger from snow, such spectacular disasters as this are comparatively rare. In this instance, on January 28, 1922, during a performance, an excessive accumulation of snow on the roof of the building caused the structure to give way. The claims for damages against the owners of the property were so great that two years after the disaster there were over 50 claims pending in the District of Columbia courts.

In a less spectacular manner, however, blizzards cause tremendous losses. A memorable blizzard occurred on March 12, 1888, when the North Atlantic Coast was literally smothered under a blanket of snow, tying up business for nearly a week. Severe storms have occurred at intervals, with 1893, 1910, and 1920 affording examples of unusual severity. In March, 1934, one of the severest storms since the blizzard of 1888 swept the eastern part of the United States, taking 80 lives, injuring countless persons, and causing great property loss. Telephone communications were severed, electric service interrupted, fuel, medical aid and food supplies cut off, fire departments crippled, and transportation completely demoralized. Heavy seas damaged dock and coast property. The effects were felt even as far south as Florida, where freezing temperatures threatened to destroy the citrus crop. In metropolitan New York 500,000 commuters were unable to get to work, and $2,000,000 was set aside to pay 50,000 men to dig the city out of the snow.

[8] The great area of the Mississippi Valley has a layer of soil that acts as a sponge, absorbing a tremendous amount of rain as it falls. In the autumn when there is an exceptionally heavy fall of rain, this soil area is frequently so saturated with water that with the coming of the spring rains and melting snows there is nothing for this additional water to do but run off at once. The result is a flood.

The great flood in the Mississippi Valley in 1927 was the result of such a situation. During August, September, and October there were heavy rains throughout the valley, and by spring the entire area of 1,250,000 square miles was saturated. With the coming of spring, it was apparent that a flood was coming. The river reached new high levels, the levee was dynamited below New Orleans and the low Delta country flooded as a precautionary move to save the city. In other places the levees gave way, and whole towns were under water; in places where levees still held, the water flowed in over the tops. Over 18,000,000 acres of land were flooded, roughly about 28,000 square miles. The loss in crops, livestock, farm, and other property damage and losses from business

Fire. Losses from fire range all the way from the destruction of an entire city, or substantial part thereof, with damage running into millions, to blazes of comparatively minor importance, where each loss is insignificant but where the total is tremendous.

The extent of the destruction wrought by fire may be estimated when it is recalled that it is probably true that a fire is destroying property somewhere in the United States every minute of the time, night and day. It is said that there is a total of 1,500 fires each day, for 365 days each year. Aside from a tremendous loss of life, the annual property loss is in excess of a half-billion dollars.

In rural communities the loss is heavy. The property loss in rural fires is estimated to be about one-third of the annual total, roughly in excess of $150,000,000. The number of deaths each year in rural fires is placed at 3,500 people.

Fire is continually breaking out in the most unexpected places and from the most unusual causes. A spark from a hammer blow, fumes from gasoline, spontaneous combustion, sparks from a chimney, defective wiring, and literally more than a thousand other causes will produce the tiny flame that may spread into a conflagration. In the field of insurance, the term "fireproof" is considered a misnomer. When man has exhausted his every resource in an effort to build structures that will not burn, his efforts are only partially successful. Fire of contents or of adjacent buildings may and frequently does cause serious damage to so-called "fireproof structures." For this reason the business of insurance generally makes use of the term "fire-resistive" instead of "fireproof."[9]

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interruption and other causes have been placed at $300,000,000. Added to this, there was a loss of more than 300 lives.

Of slightly different character are the floods in Vermont. That of November, 1927, was caused by heavy rains which fell for a short period over a mountainous region and overtaxed the capacity of the small streams. In this area there are numerous storage dams, one of which finally gave way under the tension, filled up the narrow valleys, and overflowed into the towns.

The flood catastrophe of March, 1936, involving the northeastern section of the United States and extending as far south as Kentucky, was the outgrowth entirely of a combination of natural conditions. Following heavy spring rains throughout New England, New York, and New Jersey, a huge low-pressure center heavy with moisture, moving from south to north, deluged the Appalachian slopes when the cold precipitated a rainfall. The hills were covered with snow and the rivers frozen. Swift-rising waters burst through river banks, and the resulting damage and chaos were terrific. There were 170 deaths reported, 430,000 were homeless and destitute, and the property loss exceeded $500,000,000.

[9] In this country, since the establishment of our government, over 200 major conflagrations have laid waste hundreds of millions of dollars in property values. Some of

Measuring the Hazard. When a particular form of insurance is contemplated on a given property, the insurer must make an appraisal of all the hazards involved. He must, therefore, know something of the local climatic and meteorological expectations. He must know the inherent hazards of the risk due to material, construction, and occupancy. More than this, there are the problems of location, conditions of neighboring property, possibility of loss from exposure. Finally, there is the question of facilities for minimizing the loss in the event of the happening of the contingency insured against. So, measuring the hazard involves the problem of rating, presently to be noticed. The insured must, on the other hand, select the hazards against which he wishes insurance and be able to determine those which for the particular risk are negligible.

Moral Hazard Is Psychological. The term "moral" as applied to that group of hazards that grows out of the mental attitudes of individuals is in a degree a misnomer. This is true because, while there are mental attitudes that are the outgrowth of carelessness or mental instability, and thus most decidedly contribute to a risk, in no sense do they involve moral turpitude. While the term "psychological" might be more apt, reason for the term "moral" is found in the fact that particular emphasis is given to the effecting of fraud through the deliberate destruction of insured property. It must be remembered, however, that the term "moral hazard" is in no way limited to a classification of the cases involving moral instability but includes in its scope all factors contributing to risk that are mental in their nature.

Objective Analysis Unjust. Because it simplifies the work for the underwriter, the method of objective analysis, which carries with it the assumption that moral hazard increases with the advent of motive, is widely accepted. Even those underwriters who know that moral hazard does not of necessity make its appearance with the development of a situation that makes fraud profitable, nevertheless,

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the more important of these include the Chicago fire of 1871, when approximately 17,500 buildings, valued at $168,000,000, were destroyed; the Boston fire of 1872, with a loss of $75,000,000; the Baltimore fire of 1904 destroying 1,450 buildings in an area of 140 acres, estimated to be worth $50,000,000; the San Francisco fire of 1906, covering 2,600 acres and destroying property values of $350,000,000; and numerous others where the loss ran to $10,000,000 or more, such as those in New York, 1835; San Francisco, 1851; Charleston, S.C., 1861; Portland, Me., 1866; Jacksonville, Fla., 1901; Chelsea, Mass., 1908; and Salem, Mass., 1914. Added to these are many others, where the losses ran from more than one to ten million dollars, and scores of others not included in any list of major conflagrations, where the greater part of a small community or city was destroyed in a single fire.

so far as the insured is concerned, arrive at the same position by cancelling on the ground of taking no chances.

It is obviously unjust for the insurance company which has solicited and enjoyed a substantial account during a long period of prosperity to add to its client's difficulties during a critical period by cancelling his insurance as a result of blanket instructions to cancel all lines in the industry concerned.

Psychologists have pointed out that the response to any given situation is determined by the individual's inner nature. It is essential to consider the type of character of an individual before one deduces the effects upon him of a given set of circumstances. What affects one man in one way will produce an entirely different response in another. Differences in education, social background, and training are so great that the same set of circumstances may have different and opposite effects upon two individuals who find themselves in like situations, either moral or physical.

In order to judge the effect of a given situation, such as a prolonged period of bad business or a suddenly precipitated financial crisis, it is essential that one look behind the immediate time involved and consider rather the cumulative effect of the individual's experience and training. This information will throw considerable light upon the character of the individual and what may be expected of him in an emergency or crisis.

The Influence of Past Record. Students of social psychology point out that the reaction in a moral or physical crisis is governed primarily by the cumulative effect of circumstances during the individual's past life. Appraisal of moral hazard requires the study of the character of the person under consideration in the light of his past reputation.

It is believed that, when an individual in one set of circumstances will resort to subterfuge in order to gain his ends, no great pressure will be required to stimulate similar action in a new situation. In looking up the record of an insured, therefore, the insurance underwriter is always interested to learn of questionable transactions, even though not directly connected with the business of insurance. The investigator is constantly on the lookout, for instance, for evidence pointing to the fact that his insured ever received stolen goods, or that he defrauded, or attempted to defraud, the government in matters of taxation. A previous bankruptcy record, particularly if there

is any intimation that the failure was at all tainted with dishonesty, as well as any record of attempting to secure credit upon false or fraudulent financial statement, is regarded as most unfavorable to the insured.

The question of title to property is also carefully scrutinized. When the real estate or other property that might ordinarily be available to satisfy creditors in the event of financial difficulty growing out of business transactions is held in the name of the wife, the reason therefor is questioned. The custom of placing the homestead in the wife's name ordinarily is accepted without any unfavorable connotation. It is otherwise construed, however, when the wife's name is extensively used without good reason.

Finally, investigators concern themselves with the insured's reputation in trade. They will inquire as to his standing with the banks, as to his standing with competitors in his field, and finally as to the regard in which he is held by those with whom he transacts business. The man who has a reputation for keeping his word, regardless of the contingency, indeed occupies an enviable position. On the contrary, that individual who has a reputation for being sharp in his dealings, who is noted for taking unfair advantage of legal technicalities, or who has repudiated contracts in the face of possible financial loss is regarded as one likely to resort to other unethical methods to serve his ends if a new situation should present itself.

Previous Loss Record. Obviously, a record involving a number of losses does not of itself constitute a black mark against an insured. It does, however, raise a presumption that something is wrong. It may be that the losses were deliberately planned, were the outgrowth of carelessness, or were purely accidental. In any case, an investigation is warranted.

In connection with this record of previous losses comes the reputation for honesty on the part of the insured in connection with the loss adjustment. Students of human traits point out that honesty is not of necessity a single faculty; and the dishonest features that attach to certain classes of facts are often not considered by individuals, at least until the dishonest features are particularly pointed out. Hence, an individual who has a commendable attitude toward one group of situations, so far as honesty is concerned, may be entirely inconsistent in relation to other situations. This trait frequently manifests itself in loss adjustments to the injury of the reputation of the insured.

The point is illustrated by the attitudes many individuals have toward large corporations, where a personal element is lacking. For example, in a case where a sharp practice is concerned or even deliberate misstatement whose end is fraud, individuals often feel in the case of a large corporation with hundreds of stockholders that the loss will be negligible to any one person and that there is a different element in the situation than if the transaction were between individuals. There are many otherwise honest and respectable persons who see nothing particularly wrong in taking advantage in a transaction with the government or large corporations. Obviously, insurance companies frequently find a place in this latter classification.

The undesirability of an individual with attitudes of this type grows out of difficulties in effecting adjustments, rather than the immediate dangers arising out of arson. It is to be presumed that an individual ordinarily honest in his transactions would be strongly inhibited when the temptation to arson presented itself; but with attitudes toward corporations such as those just described, difficulties in adjustments may readily be anticipated.

Excessive valuations, padded inventories, and concealment of salvage are not unusual. These devices frequently are excused or rationalized by the statement that adjusters will avail themselves of every means possible to lessen the amount of the settlement, and are therefore justified as a defense against superior experience. Individuals resorting to these practices are shocked to learn that, when found out, they are listed in the category of cheats and their practices included among those which justify the stigma of dishonesty.

The insurance underwriter, therefore, in connection with the loss record of an insured is concerned with knowing, if possible, the cause of each loss and whether or not it is tainted in any way with doubt as to its accidental origin. When this point is settled to his satisfaction, he is next concerned with the attitude of the insured in effecting the adjustments. The failure to secure satisfactory information concerning either one of these points may be a determining factor in causing the insurance to be cancelled.

Religion as a Factor. The influence of the various religious denominations and sects upon the behavior of individuals is probably beyond calculation. The attitudes growing out of a sincere religious belief are among the most powerful of all the attitudes.

It may be well to indicate the danger of confusing membership

in a religious organization with a religious attitude. Some may profess the doctrines of a religion, and nothing will be able to dissuade them from fulfilling their obligations and living in accordance with the dictates of that religion. Others may become members of the organization for the purpose of establishing business connections, for social purposes, or merely to follow the established custom and habit of the community. And still others may be heavy contributors to local charities, occupy official positions in the church organizations, not because of a sincere religious attitude, but in order to increase their prestige in the community. The man who makes an ostentatious show of fulfilling his religious obligations very often capitalizes upon his religious connections. He may contribute frequently, but he may see to it that he derives full benefit in publicity and may court the response of the community to his activities. The sincerity of such a person may justly be questioned. His religious activities, far from tending to demonstrate a favorable attitude in relation to moral hazard, may be interpreted in the opposite manner.

Still another aspect of the question is to be found in the attitudes of the egoist. For him the test of a moral question often is to be found not in the merits of the question but in appearances. He asks himself, "Will it appear right?" rather than, "Is it right?" His generous acts, charitable gifts, the correctness of all his actions are prompted by the response he expects they will elicit from his fellows. The egoist, when exposure threatens, resorts to scheming and hypocrisy to avoid being found out. He makes a frantic effort to build up a falling reputation and to maintain outward appearances. As he continues to lose ground, self-respect disappears, and the result is moral wreckage. While this breakdown does not always involve the individual in criminal activities, the latter, nevertheless, are a possible outcome.

Inspection Reports. The development by mercantile credit companies of an insurance inspection service has materially assisted the careful underwriter in his problem of selecting risks, particularly with a view to eliminating risks involving moral hazard.

The ordinary report of this type contains information concerning the age, occupation, marital status, and number of dependents of the insured. His racial descent is required; and it must be specifically stated whether he is of Anglo-Saxon, Greek, Hebrew, Italian, Negro, or other racial or national origin. His business affiliations next are

given, stating the form of organization under which he operates, as corporation, partnership, or individual proprietorship, and the position he holds therein. Next, the report requires a statement of his finances, including a statement of net worth and estimated gross annual income. A general statement is required as to character, habits, and morals, with an explanation if the report is in this respect unfavorable. Next, a financial history is required, including a record of bankruptcies and fire losses.

The next section of the report concerns itself with a description of the property of the insured, its location, the condition of the street, and its proximity to fireplugs and apparatus. An accurate description of repair is called for, including the condition of the outbuildings and the appearance of the yard. A general description of the neighborhood is required, with special reference to the racial descent of the residents and the conveniences and transportation facilities. If the property is vacant, reasons for the vacancy must be given, together with the prospects for occupancy. Finally, a list of all occupants of the building, other than the insured, must be given, together with their businesses or occupations. Information is required as to exposures in the neighborhood to vice, illegal liquor traffic, or other hazards, as well as information concerning business success in the location, competition, and personal enmities.

Occupancy and Exposure. An insured may have difficulty in placing his insurance although he may himself be beyond reproach. This may be due to the fact that in the same building, or in one sufficiently near to make his risk undesirable, an insured is located whose moral hazard is in question.

Insurance investigators carefully scrutinize those types of occupancy which might conceal illicit business, such as small hotels, boarding houses, filling stations, garages, restaurants, roadhouses, barber shops, and beauty parlors, as well as those in which the tenancy is definitely questionable or the occupant has no visible means of support.

Again, insureds of doubtful financial worth or new businesses where the proprietor has had no previous business experience are carefully watched, and a business in the name of a woman always warrants investigation to determine whether or not she is the real owner. So, too, all illogical ownerships, such as businesses and dwellings in the names of banks or holding companies, trusteeships, assign-

ments, estates, and executorships, are carefully scrutinized by the underwriters.

Problem of Location. Not only are neighborhoods and conditions therein investigated, but frequently also other types of risks in such locations are questioned. In a manufacturing risk, a failure of raw material or the development of transportation difficulties is viewed with concern. So-called "white elephant" risks, such as a hotel too large for the community or an unsuccessful summer property, are carefully studied before being accepted. Dwellings with more than one mortgage, particularly in newly opened suburbs or subdivisions, as well as extremely expensive dwellings in small communities are always the subject of special investigation.

Property Destroyed To Cover Crime. There is a type of incendiary fire that originates not primarily to collect the insurance upon the property destroyed but rather to cover another crime. Fires have been set for the purpose of destroying incriminating books and papers. There are also records where operators of dyeing establishments have sold expensive stocks of silks or other valuable merchandise and then set fire to the plant to conceal the theft. The system of contracting followed in the garment trade, where the contractor takes over valuable merchandise to his own premises, has given rise to many questionable fires. The contractor, knowing that the goods entrusted to him are insured, perpetrates his fraud by disposing of the goods himself and then burning the premises to cover the crime. Many insurance companies have refused to write such lines, or write only for those concerns whose rating and reputation are unquestioned. Similar in nature are the losses resulting when warehousemen have sold insured merchandise entrusted to them, covering the crime with an incendiary fire. Numerous cotton warehouses are believed to have been burned by dishonest warehousemen for this purpose. Fire has likewise been an instrument of fraud against life insurance carriers. Cases have been recorded where an insured burned his property and disappeared, leaving the inference that he himself was lost so that his beneficiary could recover.

Sabotage. "Sabotage" has been defined as "the malicious waste or destruction of an employer's property by workmen either during war or during periods of labor trouble."[10] It has for its purpose the ob-

[10] Steinmetz, R. C., "Arson in Times of War," reprinted from the *Quarterly*, National Fire Protection Association, July, 1940. p. 3.

struction of the regular processes of production and is limited to no particular form of destruction. Fire, and particularly fire following an explosion, is a form to which saboteurs widely resort.

It is to be pointed out that in wartime particularly, sabotage results in the destruction of millions of dollars in property values. A conspicuous example is to be found in the Black Tom Island sabotage explosion during World War I. Following twenty-four years of litigation the courts upheld awards of approximately $50,000,000 to property owners and underwriters.[11] Insurance companies collected $2,500,000 which they had paid to claimants following the loss. The balance went to the property owners who were without indemnity in the intervening period.

A feature particularly to be noticed concerning sabotage losses lies in the fact that such losses may occur in a neutral country when a war is in progress and the neutral country is a source of supply for one or both of the belligerents. In the Black Tom case just cited, the United States had not entered the war when the explosion occurred. It was only after a long period of litigation that claims against Germany for losses were upheld by the courts. It is the practice for secret agents of belligerent governments or sympathizers with one side or the other to do all possible to interrupt the flow of supplies to an enemy government.

In the case of strikes, striking employees have in the course of rioting set fire to the property of employers, and in some instances the property has been destroyed deliberately as a result of explosions. As a means for striking back by striking employees at strikebreakers, the homes, automobiles, or other property of the strikebreakers have frequently been destroyed.[12]

Fires Set for Excitement. Sometimes the motive behind an incendiary fire may be that of affording enjoyable excitement. An example of this type of attitude is to be found in the report a few years ago of the arrest of eight of the members of a fire company who were charged with originating the fires to which they respond. More than forty fires, over a period of four years, were attributed to the group. According to the report, they took their arrest as a joke and confessed responsibility for ten of the fires which had occurred within a few months just preceding their arrest. Similarly, fires are caused

[11] *The Standard*, January 11, 1941, pp. 1 and 27.

[12] Steinmetz, *op. cit.*, p. 5.

by children who wish to stir up excitement and be in the center of things. They derive satisfaction from the rush and excitement caused by the firemen in extinguishing the fire.

Irksome Surroundings a Factor. When surroundings have become irksome, individuals sometimes have resorted to fire as a means of relief. Persons unwillingly retained in institutions have sometimes fired them with the idea of creating a commotion and escaping, and at other times with the idea of revenge against society in general or the institution in particular. Homesickness has frequently been the cause of such fires, and the children responsible have often exhibited great skill and cunning in concealing their connection with the crime.

The Professional Firebug. That the destruction of property by individuals hired for the purpose is not at all infrequent is evidenced by the confessions of those who are trapped in their criminal operations or by the evidence presented in the trials. Unfortunately, since arson is a crime difficult of detection, it is reasonable to assume that this form of criminal activity is far more widespread than the actual evidence demonstrates.

The Element of Indifference. When a situation is deprived of any element of self-interest, the attitude of the individual toward that situation immediately, automatically, and sometimes unconsciously, changes. This is the type of change that is wrought by full insurance upon property that changing conditions make no longer more desirable than money. Experienced insurance men have expressed the opinion that it is not the vicious moral hazard culminating in crime that is the largest contributory cause of our fires, but the more dangerous kind of moral hazard characterized by the expression, "I should worry." The element of self-interest is reduced to a minimum whenever full insurance has been provided. It is to be presumed, however, that in the majority of instances there is a residuum of self-interest that makes the possession of the property more desirable than the indemnity provided by the insurance.

Abnormal Mental Cases. In the category of mental attitudes giving rise to an element of moral hazard, those cases involving mental abnormalities are free from any element of moral turpitude. Those individuals who are acting under an irresistible impulse to set fires are termed "pyromaniacs" by psychiatrists. The popular use of the word, however, has often led to its use when there is no mental aberration. The term "pathological arson" is more inclusive than

"pyromania," embracing within its scope cases of abnormally motivated fire-setting. Under this heading we may include the morbid propensities that give rise to pyromania, as well as cases of mental conflict, feeble-mindedness, and epilepsy.

The Pyromaniac.—Pyromania is one of the forms of mental derangement characterized by the presence of insistent ideas. An idea comes into consciousness, and the patient is powerless to overcome it. When the idea forces itself into his mind, it crowds out all others and becomes a source of great discomfort and inconvenience. Such ideas may be nothing more than a number, or a sentence, forcing its way into the mind of the patient against his will and involving no overt action. Closely allied to the derangement arising out of the presence of insistent ideas is that involving morbid impulses. Here the uncontrollable impulse to do something takes possession of the patient's mind with such force and power that restraint is almost impossible. Impulses of this type, as soon as they appear in the consciousness, may pass immediately into action.

Impulses associated with intense morbid emotional states are termed "morbid propensities." Among these we find pyromania. When suffering from a morbid propensity, the patient has an impulse to do a certain act. He is not unconscious of what he is doing but oftentimes derives great pleasure from its accomplishment. When the morbid propensity takes the form of a desire to set fires, we have a case of pyromania. The impulses often last for several days. The patient is fully conscious of the impulse, and there is nothing automatic about the act when he finally yields. He derives pleasure and relief in seeing the buildings burn. He knows that he does wrong; yet is unable to resist the impulse. Otherwise he appears perfectly normal, attends to business, and in no way betrays himself as mentally abnormal.

The Hysteric.—In the group of persons with borderline mental cases there is a type that derives great satisfaction in attracting attention in order to hold the center of the stage. This type of individual is found among the hysterics. In order to create excitement and attract attention to himself, a person suffering from this difficulty will set fire to a church, school, municipal building, or other important structure. When the fire has gained sufficient headway, the hysteric then secures for himself the center of the stage by sounding the alarm or sending for help. As the discoverer of the catastrophe, he seeks a

place of prominence. He courts newspaper publicity and is anxious and willing to grant interviews and to pose for his picture. Sometimes craving for the excitement of fires is alone sufficient to prompt setting them, and satisfaction is found in mingling with the crowd.

Other Borderline Cases.—In the case of the pyromaniac, fires are set because of the presence of morbid impulses that are irresistible, or nearly so. The element of motive, then, as ordinarily considered, is entirely lacking. There are individuals who, lacking in character, are known to react to situations that would not cause a reaction in a normal person. Likewise, a person suffering from one of the types of mental difficulty to which the law applies the term "insanity" may act upon a motive that to the normal person is both illogical and devoid of all reason.

Burnings of this type are often caused by youths fourteen years of age and upward. A few years ago a youth aged nineteen was apprehended and confessed to burning thirty buildings, with losses aggregating $169,485. He had created a reign of terror in the community in which he lived, setting fire to buildings of every sort within an area having a 10-mile radius—from barns and dwellings to schools and churches. The fires were usually set in the night, and frequently the roads were obstructed to hamper the arrival of fire-fighters. Youths in this class are characterized by a lack of emotion or affection and often have cruel dispositions. When apprehended, there is no evidence of sorrow, even when loss of human life has followed in the wake of their acts.

FOR REVIEW

1. Distinguish between the insurance use of the terms "risk" and "hazard."
2. Distinguish between "physical hazard" and "moral hazard."
3. X lives in a midwestern state. Of what interest to him is the ice menace in the North Atlantic or tidal waves in the Pacific?
4. Describe the method of objective analysis. Criticize.
5. B's loss record shows three fires in a single year. What further information will the underwriter require before passing or rejecting the risk?
6. Discuss the use made by insurance companies of inspection reports.
7. Aside from defrauding insurers, what other motives prompt the destruction of property?
8. Describe the activities of the professional incendiary.
9. Describe the attitude of the underwriter when indifference on the part of the insured may be a factor.
10. Are all people who deliberately set fires pyromaniacs?

11. A sudden change in the styles of women's hats leaves many of the wholesale milliners of the country heavily stocked with out-of-style merchandise. As an insurance underwriter, what steps would you take?
12. Make a list of the industries in your community which might be affected by acts of sabotage directed against them during wartime.
13. The motives for arson with reference to business and industry have been classified by Dr. Richard C. Steinmetz as follows: (*a*) economic gain, assured benefits directly; (*b*) economic gain, assured is innocent party, but the perpetrator benefits directly or indirectly; (*c*) personal satisfaction, attainment of a goal, or furtherance of a cause; (*d*) concealment of some other criminal act; (*e*) arson by the mentally afflicted. List as many motives as possible under each of the above classifications.
14. The hazards or risks covered by insurance, according to D. Alfred Manes, arise from one or another of the following causes: (*a*) elementary powers and forces; (*b*) human actions, either punishable or unpunishable; (*c*) economic developments; (*d*) political reasons. Give examples that fall into each category.
15. "Over-insurance leads to fraud, full insurance to carelessness, and even partial insurance to some diminution of watchfulness." This statement is made by Willett in *The Economic Theory of Risk and Insurance*. It sounds like a severe indictment and is unquestionably true. Justify insurance in the light of this statement.
16. It has been stated: "Whenever there is a situation where particular consequences rather than others seem interesting and attractive, there is said to be a motive for effecting the desired consequences. Motive is the frame of mind that indicates why an end or consequence is to be desired, and is distinguished from intention which is the concrete aim to effect the foreseen results that are wanted. Hence it is obvious that motive can exist without intention." Do you believe this to be true? Discuss from the point of view of an insurance underwriter.
17. Discuss the problem of moral hazard arising out of an attitude of indifference engendered by a lack of self-interest.

CHAPTER IX

RISK

RISK Defined. "Security" is a relative term. No one living may, in handling his economic affairs, ever reach the state of absolute security or complete certainty. While the eventual termination of life is certain, the time of death's arrival is unknown; and from the moment of birth until life has ceased, every individual, no matter who he is or how he lives, is constantly facing the probability of some happening that is unwanted and to be avoided. Ownership of property carries with it the possibility of destruction through the operation of the forces of nature and hence its loss. The uncertainty of the happening of an unfavorable contingency has been termed "risk." More simply, from the standpoint of insurance, risk is present when there is a chance of loss.

Insurance underwriters class economic risks as (*a*) speculative risks or (*b*) pure risks.[1] Speculative risks involve both the chance of loss and the chance of gain, whereas in pure risks there is only the chance of loss. The business of insurance concerns itself with the economic problems created by pure risk. To contrast the two classes, speculative risk is here noted briefly.

Speculative risk, because it involves an element of both profit and loss, may be nullified by a process known as hedging. For example, a manufacturer who buys raw material, to be converted into a finished product to be offered for sale sometime in the future, may suffer a severe loss if the price of the raw material falls before the finished product is offered on the market. If the price of the raw material rises, he will enjoy a speculative profit. Since a manufacturer is in business to make a profit on his manufactured goods, he is interested in relieving himself of the speculative risk. This is accomplished by the practice known as "hedging." At the time he buys his raw material he will sell short an equal amount for delivery at about the time his finished product is offered on the market. "Selling the material short" means selling goods he does not have by obligating himself to make delivery in the future. Thus if the manufacturer sells raw

[1] Mowbray, A. H., *Insurance* (1st ed.; New York: McGraw-Hill Book Co., Inc., 1930), p. 5. This terminology follows Mowbray's definition of risk as "the chance of loss."

material on a current market for delivery in the future and the market advances, he will lose money on his short sale but will make up the difference on the goods in process. If the material sold short declines in price, the manufacturer will make a speculative profit on the short sale but a corresponding loss on the manufactured goods. The net result of the hedge is to eliminate speculative risk and make the cost of the raw material reflect the current market price at the time the goods are offered for sale. The person through whom the short sale is effected may be a speculator whose business is the assumption of speculative risks for a profit.

The term "speculation" is sometimes associated with gambling. The legitimate use of funds in speculative enterprise forms an important part of our economic system; and the speculator who, motivated by the possibility of higher return, is willing to assume a greater risk than the conservative investor contributes to productive enterprise. The gambling or wagering risk, on the contrary, is nonproductive and in this country is illegal, as contrary to public policy. The wagering risk is a risk created by the transaction itself; that is, until a wager is made neither party is subject to the risk in question, but after the wager is made both parties are subject to the risk of loss; also, there is the chance of gain.

A pure risk, because it involves only the possibility of loss, cannot be neutralized by an opposite contract, as in the case of hedging a speculative risk. Take, for example, the case of the manufacturer already cited. His plant may be destroyed by fire, windstorm, or earthquake. He may have taken every means within his power to prevent such losses; but after he has exhausted his resources, destruction still is possible. The temporary shutdown of the property because of the happening of some contingency may interrupt profits. Accidents may involve liability claims. Trusted employees may abscond with company resources. Customers may go into bankruptcy and fail to pay accounts. There are innumerable risks of this nature which cannot be handled by hedging and which cannot be eliminated by prevention. It is the burden of such risks that is shifted by insurance. The insurance business does not, as an actual fact, minimize or eliminate a pure risk, but it may effect a transfer of the risk from the shoulders of the person to whom it attaches to another more willing to bear it. The person who transfers the risk is the insured, and the person to whom the risk is transferred is the insurer. A payment is

made by the insured to the insurer, and this insurance is said to effect an exchange of a known small loss for a possible large loss. Insurance, then, in relation to pure risk makes certain the cost of loss to the individual.

Modern Economic Structure Involves Many Risks. The risks attaching to every sort of human enterprise—indeed, to existence—are multitudinous and range from the unavoidable to those assumed by choice. Disease, accident, the onset of physical incapacity with old age, and death are risks attending human existence. On the other end of the scale are hazardous forms of business enterprise, undertaken through choice for profit. Such, for example, would be the investing of money in real property that may be destroyed by the forces of nature. Between these two categories are many degrees of risk. Risks that are unavoidable, or risks that it may be desirable to assume so far as the individual is concerned, may be handled either by assuming all the consequences of loss arising therefrom or by seeking some method of mitigating or eliminating a possible loss. Out of the search for security, insurance was born.

Classification of Risk. The uncertainties confronting man are ordinarily divided into three classifications. The first of these classifications of risk is ordinarily termed "personal" and is chiefly concerned with death and the time of its occurrence. It is perfectly apparent that of death there is no uncertainty; but the time of its occurrence is uncertain. And, aside from death, there is the risk of curtailment of capacity through accident, illness, or old age.

The second classification of risk is that which arises from the destruction of property. The possible loss of a cargo or ship at sea is considered a risk to those engaged in maritime operations. Fire, lightning, windstorm, flood, and other forces of nature offer a constant threat of loss to real estate. From catastrophes arise consequential losses, such as loss of rent because of the destruction of property, loss of a business location and profits, or the termination of a valuable lease.

The third classification of risk is occasioned by the operation of the law of liability and may be termed "third-party risks." Whenever an individual is legally liable for an injury to another, as, for instance, through an accident when the driver of an automobile is negligent and injures a pedestrian, or when a person is injured in a passenger elevator, such a risk is termed a third-party risk. It is so

called because when insurance is used to shift the burden, the insured, who pays the premium himself, receives no direct remuneration upon the happening of an unfavorable contingency but is assured that payment will be made for claims against him to injured persons for whose injuries he is legally liable, and that he will be relieved of the expense of defending suits whether or not liability is present.

Shifting the Burden. It is at once apparent that innumerable risks attaching to the wide range of human activities are of little consequence from the point of view of the individual to whom they attach. For example, a man may lose his glove or break his spectacles. There is a loss, but its severity is not sufficient to cause acute suffering or seriously affect the future course of the injured person's business or standard of living. Such risks may be ignored. The destruction of a factory by fire, the serious interruption of production through engine breakdown, theft by dishonest officials, and other losses involving large sums are, however, matters of concern.

The first step toward a solution of the problem is prevention. A careful study of the causes that give rise to losses and the deliberate undertaking of means to minimize the risk constitute the most logical and reasonable procedure. But after we have exhausted our resources and utilized every practicable means for prevention, there remain risks that carry with them the threat of disaster.

After steps toward prevention have been taken, measures may then be instituted toward shifting the burden of the risk for a consideration to the shoulders of a "carrier" willing to bear it. Through the consolidation of a large number of risks, what amounts to an uncertainty for the individual to whom each risk attaches may in the aggregate be reduced to a virtual certainty for the entire group. In the business world there have developed a number of carriers, or insurers, who have become specialists in risk bearing. This specialization is possible because of the limits within which it is possible to compute the cost of carrying risk. The shifting of the burden of the risk is the process to which we apply the term "insurance." This is the means developed by modern business practice for handling risks when prevention is impracticable or impossible.

Insurable Risks. As a matter of theory, it might be stated that all risk is insurable. Because of the element of expense in carrying on the business of insurance, premiums are weighed with a charge to provide for this cost. In the instance of risks that carry with them a

threat of no great consequence, it becomes apparent that the cost of handling the business would make the rate prohibitive. Hence, in order to make a risk insurable, as a matter of business practice the danger of loss must be sufficiently great to make the cost element a minor factor in the premium charged.

A second and more important requisite of an insurable risk, however, is found in the necessity of its being of a nature that permits of statistical commensuration or, failing this, permits of a reasonable estimate based upon conclusions drawn from experience though predicated largely upon judgment. As a corollary to this requirement, the risk must be one of which there are a large number in existence, though it will be presently noticed that insurers occasionally cover isolated risks concerning which there is no previous experience and when the chance of loss is measured by attendant circumstances. The volume of insurance is written, however, to cover accidental hazards where losses may reasonably be expected and where mathematical treatment or judgment based upon experience permits a sufficiently close estimate of losses to make possible a workable estimate of their probable cost. When experience extends over a number of years and the number of risks is great enough, a premium can be computed that will assure a sum sufficient to pay losses, compensate the carrier, and provide stability and permanence in the business, instill confidence in the insured, and, through the promise of stabilized earnings, assure the business of new capital when needed.[2]

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[2] Indicative of the many sources from which a loss may spring and of the multiplicity of insurance contracts devised to handle the risks, the following list is presented: fire, windstorm, business interruption, loss of rental income, loss of leasehold interest, loss of profits and commissions, leakage of plumbing and heating systems, leakage of sprinkler system, boiler explosion, flywheel explosion and engine breakdown, electrical machinery breakage, burglary of stock, broken glass, riot, strike, and civil commotion, explosion (from outside sources). The owner of an ordinary building might think that his principal risk was from the destruction of the property by fire. To protect himself he buys fire insurance. The foregoing list of possibilities of loss, arising solely out of ownership and occupancy of the building, readily indicates the inadequacy of such protection and the care and technical knowledge necessary to provide an adequate insurance program.

These sources of loss have reference only to the physical destruction of property. Another source of loss, that may give rise to damage far in excess of the value of the property, may result from liability for injuries to persons, or damage to the property of others. Such losses may be occasioned by (*a*) injuries to employees; (*b*) injuries to the public in and about premises by elevators, teams, automobiles, or by explosion of boiler, flywheel, or engine; (*c*) damage to the property of others by elevators, teams, automobiles, water, or the explosion of boiler, flywheel, or engine; (*d*) negligence of contractors; (*e*) negligence of subcontractors.

While the business of insurance places great emphasis upon statistical data and the use of the mathematical theory of probability, it is not an essential requirement that the probability of the occurrence of the contingency to be covered by insurance be definitely known. In certain of the older forms of insurance, future expectation on the basis of past experience can be computed with a fair degree of accuracy. When new insurance forms are instituted, it becomes necessary to make rates that are dependent upon what is sometimes called "underwriting judgment," and in some instances this is nothing more than an approximation or guess to be adjusted with the accumulation of experience.

Risks Insured. That the business of insurance has accommodated itself to almost every conceivable type of pure risk can readily be seen. Aside from the more unusual coverages, such as those that indemnify if twins are born to the insured, or if he is obliged to support his mother-in-law, or if war is declared, or if he fails to swim the English Channel or fly the Atlantic, a glance at the list of standard coverages obtainable at almost every hamlet is indicative of the extent to which the burden of risk is shifted through the use of the facilities afforded by commercial insurance.

Insurance Is Not Prevention. The terms "insurance" and "security" are not interchangeable. It is necessary to distinguish between the elimination of hazards, thereby lessening or eliminating risk of loss, and the provision for indemnity in the event of loss from an existing risk.

It is natural when a pure risk threatens that every reasonable step be taken to eliminate it or minimize it through the agency of prevention. Thus, we build fire-resistive structures. We install protective devices in manufacturing boilers to eliminate accidents. Inspections are made of boilers to detect latent defects. Installations are available to control lightning. Attempts are made to prevent floods through the agency of control projects. Construction is aimed at the elimination of tornado, earthquake, and hurricane losses. Steps to prevent losses extend from efforts of the individual to community undertakings. Some of the larger projects, such as those involving flood control, are carried on by the national government.

When it is recalled that the foregoing possibilities of loss grow out of the possession and occupancy of a piece of property, some conception is possible of the multiplicity of risks encountered by an active individual.

So far as prevention is effected, it saves the property in question from loss.

In contrast to prevention, insurance saves nothing. It has, to be sure, certain social values which already have been noticed. However, if property is insured, the insurance will in no way protect that property from loss or damage. Insurance indemnifies the owner of the property, and the payment is made out of the fund to which all insured members have contributed. There is a distribution of property following an insurance loss, but the sum total of the property is lessened by the amount of loss. In an effort to reduce the cost of insurance to a minimum, insurance, it has already been noticed, stimulates use of protective measures and to the extent that it is successful it is an agency for the actual preservation of property. On the other hand, insurance likewise contributes to a certain amount of loss through incendiarism, suicide, or other losses instigated in an effort to defraud insurers.

More often the two methods of obtaining security, prevention and insurance, are combined. The owner of capital goods subject to a number of hazards may take every known precaution, install every known safety device, and still there may be hazards which he cannot eliminate. Or it may be that in weighing the costs, insurance up to a certain point is the more attractive. In any instance, insurance begins where prevention ceases. Even though the elimination of hazards in any case materially lessens the cost of insurance, the cost of such prevention cannot be termed a payment for insurance even though it is a payment for security. The concept of insurance will not extend itself to include prevention, but limits itself to the provision of indemnity where the risk to the capital covered remains in existence. The same psychological drive that gives the idea of insurance its momentum has likewise given rise to the development of preventive measures, the two ideas having a common purpose and progressing along parallel lines.

Risk a Condition Precedent. The presence of risk as a condition precedent is the factor that removes insurance from the category of a gambling contract. It makes as an essential requirement the transfer of the existing risk or its burdens from the shoulders of one to those of another, and it is upon the basis of this existence of risk that the requisite of insurable interest rests. Modern insurance practice holds any contract lacking this element to be against public policy. The

inclusion of insurance in the gambling category seems to be erroneous, and a review of the distinguishing factors will assist in clarifying the concept.

Insurance, then, does not permit the creation of a risk but is, on the contrary, the assumption of a risk already existent. Contrasted to this is a bet; so far as the individuals in the transaction are concerned, no risk had heretofore existed, but one is created by placing a stake in hazard on the outcome of some contingency lacking the element of mutual benefit. Such a transaction is economically unsound. The buyer of insurance is a buyer of security, and for a specified sum the seller of insurance furnishes that security. The contract is mutually beneficial.

Tendency To Minimize Risk. It seems to be an innate tendency of human nature to underestimate the gravity of risk. In the days when the business of insurance was in its infancy, Adam Smith recognized this tendency when he wrote:

> The over-weening conceit, which the greater part of men have of their own abilities, is an ancient evil, remarked by the philosophers and moralists of all ages. Their absurd presumption in their own good fortune has been less taken notice of. It is, however, if possible, still more universal. There is no man living who, when in tolerable health and spirits, has not some share of it. The chance of gain is by every man more or less overvalued, and the chance of loss is by most men undervalued, and by scarce any man, who is in tolerable health and spirits, valued more than it is worth.[8]

This contempt of risk and presumptuous hope of success are particularly to be noticed in young people. It is of the utmost importance that this natural tendency be thoroughly understood by those who undertake the careful appraisal of risk. Individuals will frequently recognize and admit the value of particular forms of insurance coverage, yet deny without logical reason its utility to them because of this tendency to underestimate the risk in their own particular case.

Values Distorted. Another aspect of the problem presents itself in a tendency to distort the relative importance of different risks. For example, there is a tendency on the part of individuals to disregard risks to which they have been accustomed. They often become entirely unconscious of the existence of such risks. Man likes to do things the old way and has a dread of new methods or change and,

[8] Smith, Adam, *Wealth of Nations*, Book I, chap. x, Part I.

for this reason, tends to postpone the adoption of new methods or projects. But when he does make the change, he is inclined to be acutely conscious of conditions involved, including, of course, the risks that the venture entails.

Consider, for example, the individuals who invest a few hundred dollars in an automobile and who refuse even to accept delivery until their investment is covered by insurance. Those same individuals, however, have been entirely oblivious of the fact that loss of earning power through an accident would involve a far greater financial loss than the destruction of the car by fire or accident; yet nine times out of ten the car will be insured and the accident and health coverage upon the car owner disregarded.

Risks attaching to every sort of human enterprise may be classified roughly into two divisions: the unavoidable and those assumed by choice. Disease, accident, and the onset of physical incapacity with old age are risks that all must face and fall into the first category. In the second category are to be found forms of business enterprise to which hazards attach but which the individual undertakes through choice. There are risks attaching to the individual in modern society, in theory assumed from choice, but actually undertaken because of the requirements imposed by the group of which he is a member. As a matter of theory, one need not make use of furniture or use a dwelling for shelter. As a matter of fact, however, the mores of the group eliminate free choice, and the individual is faced with risk. Risks offering no choice as to whether they will be assumed or avoided are those to which the individual becomes conditioned and which he tends to underestimate, if not entirely to disregard. On the other hand, if a new and strange enterprise is suggested, before making any step all risks are weighed, and the decision for or against the venture is based in a great part upon this appraisal.

Risk Appraisal the Essence of an Insurance Program. While it is possible to form categories based upon economic status, profession or occupation, income, or the like, it will still be found that every individual within a group presents an individual problem with conditions peculiar to himself. For this reason, in every case in the selection of insurance coverage it is essential to have an accurate and careful survey of the insurable risks involved. The task then resolves itself into appraisal, with a view to selecting those risks for insurance that involve the possibility of disastrous losses. Risks

must be carefully compared, for it is possible to spend large sums in buying comparatively unimportant forms of insurance coverage while inviting the most serious consequences through a failure to provide essentially needed coverages. Not only are haphazard programs usually more expensive than necessary, but they are also frequently incomplete or inadequate.

Insurance Planning. It is becoming more and more a recognized fact that the arrangement of an insurance program to fit individual needs is work for a trained technical expert. No longer can the insurance agent be a mere solicitor or order-taker. The business or professional man who allows friendship or social contact to be the dominant factor governing the selection of his insurance adviser may find himself without the protection he needs or paying an exorbitant amount for excessive or duplicating coverages. Because of the complex nature of forms, coverages, rate structures, and the like, it is essential that the insurance adviser be selected with the same care and discrimination used in choosing other professional assistance.

The Insurance Survey. To meet the growing demand for planned insurance service, forward-looking agencies have incorporated as part of their agency equipment facilities for making insurance surveys. These surveys are known under a variety of names. They are called "insurance plans," "insurance abstracts," "insurance analyses," "audit-surveys," and other such names. In practice each is essentially the same, and all are designed to uncover points of weakness in existing insurance programs. A suggested rearrangement of insurance amounts and coverages is then presented, and some of the plans go so far as to indicate risks that the insured himself may carry with profit, and where insurance is therefore not needed.

The insurance survey is particularly adapted to the needs of a trustee who, entrusted with new and unfamiliar responsibilities, is disturbed by many perplexing problems. Ecclesiastical dignitaries, state and city officials, corporation directors, guardians, executors, and trustees are subjecting themselves to grave criticism, if not direct personal liability, if without verification they are satisfied that the insurance programs of their predecessors are sufficient. Frequently men who are otherwise qualified for a position, such as that of a trustee of a church or college, have but the vaguest idea of the risks that threaten the institutions under their care. Verbal recommendations or suggestions may be misunderstood or misinterpreted. The

carefully prepared insurance program presents a logical solution of the problem.

The insurance plan, while of especial interest and value to large business undertakings and to institutions, is by no means limited in value to large enterprises. Surveys are provided for individuals under a plan known to insurance underwriters as the "personal form." While risks with which the individual is personally concerned are limited, they vary with occupation or profession, ownership of real estate, habits, pleasures, and diversions. The problems of the traveler abroad differ from those of the traveler at home. The doctor who uses radium or the dentist who extracts teeth has his own special problems. The personal survey brings all of these to light. Again, while cost is of importance in every insurance program, its distribution may be of especial interest to the individual. It sometimes happens that heavy premium payments fall due about the same time that taxes, notes, or other extraordinary expenses are payable. If the insured is operating on a budget system, he may secure a plan for the readjustment of premium payments to fit his financial planning. If budgeting is not followed, insurance may be rearranged so that the heaviest premium payments fall due at a time when some particular income is received, or in any manner that will prove most convenient to the insured.

FOR REVIEW

1. With relation to risk, what is the function of insurance?
2. Are all risks insurable?
3. A agrees to pay the Incandescent Fire Company $60. If his house burns, the company agrees to pay A $5,000. This is not a bet. Why?
4. B owns a car valued at $1,000. It is insured against loss by fire, theft, and collision. The premium is $120. What risks created by the ownership of the automobile are more important to B than the loss of his car?
5. What risks should be insured?
6. Distinguish between the terms "direct-loss insurance" and "third-party insurance."
7. Outline the advantages of an insurance survey to a trustee of a university or director of a bank.
8. Would it be good business for a speculator to buy insurance on the life of a revolutionary leader? Discuss the question of legality.
9. Does the average person have a tendency to overinsure?
10. In Boston, on October 11, 1937, a musical comedy opened entitled *I'd Rather Be Right.* With skillful mimicry the actors imitated important public personages, among those who were burlesqued being President

Roosevelt, his family, his cabinet, and the Supreme Court. The producers are said to have insured against the possible death of President Roosevelt. Is such a contract sound from an insurance point of view, or is it in the category of a wagering contract? Explain. Reconcile your answer with your answer to question 8 above.

11. List the characteristics for which you would search with reference to any given hazard to determine whether or not in your opinion the hazard is insurable.
12. Alfred Marshall in *Principles of Economics* makes the following statement: "Again, certain insurance companies in America take risks against fire in factories at very much less than the ordinary rates, on condition that some prescribed precautions are taken, such as providing automatic sprinklers, and making the walls and floors solid. The expense incurred in these arrangements is really an insurance premium. . . ." In a strict economic sense is this statement correct? Give reasons for your answer.
13. It is said that the risk that an insurance company carries is far less than the sum of the risks insured. For example: "The aggregate danger is less than the sum of the individual dangers. . . ." (William Roscher, *Principles of Political Economy*). Do you agree or disagree? Give reasons.
14. Distinguish between "hedging" and "insurance" as methods for handling risk.
15. Distinguish between "insurance" and "gambling."
16. Do you think risk can be handled by avoidance?
17. Do you believe that uncertainty in economic affairs causes a net loss to society in addition to all the losses occasioned by the occurrence of unfavorable events? Justify your answer.
18. In the case of two persons having a $1,000 with the same marginal utility, it can be shown that in the case of a wager there is a net loss to the two as a result of the transaction. Explain.
19. The philosophers tell us there is no such thing as chance. "Though there be no such thing as chance in the world," says Hume, "our ignorance of the real cause of any event has the same influence on the understanding, and begets a like species of belief or opinion." If this is true and there is no such thing as chance and uncertainty is the outgrowth of our ignorance of the real cause of an event, can the problem of uncertainty as it affects hazards to property be solved with an increase of knowledge? Can uncertainty be thereby entirely eliminated?
20. Writing in 1913 Mr. Miles M. Dawson, commenting on the money value of a man's life, stated: "The principles upon which a correct estimate of the value of a human life must proceed are in brief as follows: The financial value of a man's life to others or to his business as a thing apart from himself is obviously the amount of money over and above the cost of his own maintenance at the standard of living which he has adopted, for such period as he would normally be expected to live and continue in active business." Recent studies by the Metropolitan Life show that at any productive age a life is considerably more valuable today as measured in money than when Mr. Dawson wrote. Why?

Chapter X

QUANTITATIVE MEASUREMENT OF RISKS

Insurer's Advantage. While it is the function of insurance to assume the burden of the risks which individuals are unwilling to carry, the insurer is able to reduce the sum total of all the uncertainties involved in the risks that he carries to a reasonable degree of certainty. Therefore, within calculable limits the insurer is able to foresee the losses that will occur in a given number of instances. He is thus able to compute the premium charge to pay all losses, as well as to cover expenses and profits. For each individual the degree of uncertainty may be extreme and the possibility of loss enormous. For the insurer this element of uncertainty is reduced to a minimum through the utilization of the statistical sciences and the application of the mathematical principle of probability. The insurer is concerned not so much with the fact that there will or will not be losses as with his ability to predict their extent and fix his premium charge accordingly. The ability to do this places the insurer on quite a different footing from the insured.

Probability a Factor. By means of the application of the theory of probabilities it is possible for the insurer to predict within comparatively narrow limits what the losses will be. Were it not for this ability to estimate within reasonable limits the percentage of losses that will occur to insured property, insurance would be nothing more than the accumulation of many small chances into one enormous chance. As a matter of fact, it is nothing of the sort. Whereas in each individual case the element of uncertainty is extreme, in the sum of the accumulated cases a definite loss may be predicted, even though the uncertain element is not entirely eliminated.

Profits of insurance companies vary. Some companies are successful; others are not. Although every company endeavors by a judicious selection to eliminate especially undesirable risks, every company, nevertheless, is certain that in spite of its best efforts losses will occur. Its entire business structure is predicated upon this conclusion. The possibility of estimating and planning for future losses through the utilization of the theory of probabilities is what gives to

the business of insurance a basis of stability and makes possible the dealing in risks on a basis of comparative certainty.

Knowledge as a Factor. The philosophers have told us that there is no such thing as chance. Only because of an imperfect knowledge is there any uncertainty. The storm that sweeps across the land is the result of the operation of definite natural forces. An infinite or perfect knowledge would eliminate any element of chance from the happening. The result would be clearly seen and understood. The lightning, when it strikes, follows no whim. Definite natural laws are called into play. Lack of knowledge alone limits our capacity to foresee or predict these results. Obviously, an infinite or perfect knowledge is beyond human capacity. The theory of probability deals with the quantity of knowledge that is available in a given situation in an effort to predict future events. For example, when there is a possibility of one of two events happening, as the appearance of head or tail at the toss of a coin, when the evidence favoring either possibility is the same, the probabilities are said to be equal. Additional evidence of a favorable nature permits the conclusion that the possibility thus favored is more probable. The theory of probability permits us to go beyond the immediate findings of observed data and shows us what we may assume for the future in the light of past proceedings.

The Moral Theory of Probability. The earliest consideration of probability is to be found in the works of those writers who concerned themselves with situations in which the actions and responsibilities of the parties were in doubt. Such problems are to be found in abundance in the Talmud, as well as in the earlier writings of the Greek and Roman philosophers. As with the theologians of later days, the learned casuists as far back as classical antiquity were at a loss to solve the problems of moral behavior to the satisfaction of all. For example, it was frequently a matter of doubt as to whether under particular circumstances a certain rule applied and should be enforced.

It was understood that, when there was certainty with regard to a prohibiting law, all subject to the law were bound to abstain from performing such action as the law forbade. On the other end of the scale, no obligation existed when there was no law. In both of these cases there is no doubt, but certainty. Between these two extremes, however, there can be all degrees of uncertainty as to the

existence or application of a prohibiting law. Doubt, in its strict sense, is said to exist when there are no positive arguments either way or when the arguments are equal. Then there can be a preponderance of opinion in favor of the law, with the opposite opinion still probable. The opinion favoring one view can be more probable than the opposite, most probable, or slightly probable.

The Application of Mathematics. The theologians in their works, developing the fundamental hypothesis of Aristotle, indicated that no truth could be assumed from any of our ideas, but only varying degrees of probability, and definitely drew attention to the fact that there was a "theory of probability" applicable to ethical and moral convictions. To Blaise Pascal we owe the application of mathematics to probability. We are indebted to him for the first explicit formulation of the principle of recurrence, stated in a tract called *The Arithmetic Triangle,* published in 1654.[1]

The theory evolved has, in the field of insurance, proved to be an instrument of incalculable importance. The measure of probability is expressed algebraically by means of a fraction whose numerator is the number of favorable (or unfavorable) possibilities, and whose denominator is the number of all possible cases. Using the following notation, in which n represents the number of ways an event can occur, a of which are to be considered as favorable and b

[1] It has been found upon investigation, however, that the material in this tract was also contained in the correspondence between Pascal and Pierre de Fermat regarding a problem in gambling, and that correspondence is now regarded as the point of beginning from which developed the mathematical theory of probabilities.

The problem was stated: "Given the number of points necessary to finish the game and the score of each player, how are the stakes to be divided between them?" Fermat took as a case a situation where A, when the game was interrupted, required two points to win, while his opponent B needed three. It can be seen that the game could be decided in not over four more trials, for if B should win the first two and lose the next two, A would secure the necessary score. If B won the first two, and either the third or fourth, B would win. By no shifting of the possible arrangement of scores would there be more than four more trials. Fermat, in determining the chances of each player, took two letters, *a* and *b*, and wrote down all the possible combinations that could be formed by four of them, as follows—*aaaa, aaab, aaba, aabb, abaa, ... bbbb*—and found the total possibilities to be sixteen in number. He then took his array and determined which of the cases were favorable to A and which to B. Because A needed two successful trials to win, he determined that those cases where *a* appeared two or more times were favorable to A, and by the same reasoning where *b* occurred three or more times, those cases were faborable to B. Upon inspection of the sixteen cases, it appeared that there were eleven favorable to A, with five favorable to B. The stakes, therefore, were in this instance to be divided in the proportion of eleven to five. Another problem was considered which concerned the probability of throwing a six with a die in eight throws. Fermat apparently carried the work no further, but Pascal developed the problem, carrying his researches to other and more difficult cases.

as unfavorable, then the probability of p, a favorable outcome, can be expressed $p = a/n$, and the probability of an unfavorable outcome is written $p_1 = b/n$. A simple illustration of the formula is found in the experiment of tossing a coin. There are but two ways in which a coin may fall: either head up, or tail up. The probability that it will fall head up is found by using the number of possible successful chances as the numerator of the fraction, and the total number of chances as the denominator; and we have the probability of tossing a head as $1/2$. The probability that it will fall tail up is the same. The value of the theory of probabilities to the science of insurance, it can readily be seen, is dependent upon the accuracy of statistical data.

Probability and Uncertainty. Probability measures the chance of occurrence of a particular event. With relation to any given event, the two extremes are certainty and impossibility. Between the two there are varying degrees of probability. It will be recognized, however, that the degree of certainty and the degree of probability do not represent similar concepts. If a thing is certain to happen, then its probability is represented by unity, or 1. If it is impossible that it should happen, there is no probability, or probability is represented by 0. Impossibility, then, is negative certainty. That is, the event is certain not to happen.

When the chances for and against the happening of an event are equal, the probability is expressed by $1/2$. At this point the uncertainty is greatest. If, for example, the chances are reduced to one out of four, the probability is $1/4$; but it is likewise more certain that the event will not happen. Should the chances be increased to three out of four, the probability is expressed as $3/4$. In this instance, the degree of certainty is the same as before, but on the positive side. This time the event is more certain to happen. In other words, as the probability increases or decreases from $1/2$ moving toward certainty or impossibility, the element of uncertainty is diminished. At the end of the scale where probability is the least, certainty is increased. Likewise, at the end of the scale where probability is greatest, there is an equal degree of certainty.

The Law of Great Numbers. Only occasionally is the insurance underwriter concerned with the probability of the happening of a particular event. He is more often concerned with the number of times he may expect an event to happen over a series of occasions.

It has been observed that certain happenings that appear to be

the result of pure chance, when isolated instances are considered, occur with surprising regularity when a large number of instances have been observed. It has further appeared that the regularity of the happening increases as the observed instances become more numerous. The impossibility of predicting a happening in a particular case gives place to probability when a successive series of possibilities is considered.

Applying these conclusions to insurance, we find that every year a certain number of dwellings burn, accidents happen, deaths occur. The contributing causes are so numerous that it is not always possible to draw definite conclusions from cause to effect. It is to be learned from observation that the operation of all causes effects a certain result. Now, if we isolate a small group of cases, we may find a wide variation between the actual experience of that group and the expectation as determined by the past experience of the entire group. If the number of cases is too small, the variation may be far out of line either in one direction or the other. As the period of observation is lengthened, the variations tend to cancel each other; and as the number of cases is increased, the extent of irregularities is lessened.

Because of the operation of the law of large numbers, often termed the "law of averages," insurers have learned the wisdom of including in their portfolios the largest number of risks possible. For this reason insurers limit the amount they will carry on a single risk and attempt a sufficient geographical distribution to minimize the danger of large losses from a single catastrophe. A great number of small risks properly distributed insures a more regular and more accurately predictable loss ratio than follows in the case of concentrated and unequal distribution. The greater the number of risks, the more stable and certain will be the business.

Average and Deviation. Experience has demonstrated that in a particular group of risks for a given period the losses will not of necessity correspond exactly to the average loss as indicated by statistical evidence. Losses vary from year to year, one way or the other, from the average figure. The insurer who is interested in eliminating uncertainty must recognize this element of variation and make provision for meeting it. Accordingly, he is interested in knowing not only the probable losses for a given year but also the probability of a deviation from the predictable average.

To arrive at the probable variation from the average, it is neces-

sary to know the actual variations from the average during the years over which the statistical information was compiled. In a series in which the individual variations from the average fluctuate in a narrow range, the probable variation will be less than is to be anticipated in the case of a series in which the number of fluctuations has been great. The probable variation is derived through calculating the average of the variations during the period being studied.

Mathematical probability, then, enables us to predict the probable losses for a given period. Because of fluctuations from the average, we are able to determine not only that a certain number of losses are bound to occur but also, in addition to these, that there will be an uncertain number not definitely possible to predict. The actual limits of this uncertain area are measured by the limits of the variations. The probable limits of the uncertain area are found by determining the probable variation.

In connection with this problem of variation, it can be shown that the greater the number of cases included in the statistical material, the less is the ratio of the probable variation to the number of cases under consideration. The element of uncertainty, therefore, is greatly lessened proportionately as the number of cases for statistical consideration increases.

Subjective Probability. In certain instances the question of probability is not readily subjected to statistical treatment. Nevertheless, insurers have been willing to estimate the probability and insure the risk. A case in point arises when an attempt is made to reinsure a ship overdue. Years ago, when travel was slower and when there was no wireless communication, ships due in port were anxiously awaited. When the time for arrival passed with no word from the expected ship, anxiety turned to apprehension. In such instances, notwithstanding the fact that ships were not uncommonly late in making port, insurers, anxious to lighten the load, frequently sought reinsurance on the ship, "lost or not lost."[2] The high rate and the chance of gain appealed to the reinsurer.

[2] In placing reinsurance upon a ship "lost or not lost," it is lack of information that gives rise to the uncertainty. When the reinsurance is placed, the ship is either lost or afloat. No discussion of previous wrecks could affect that particular ship. It is not with what may happen to the ship that the parties to the contract are concerned but with what may have happened to it. The uncertainty, then, is in the minds of the interested parties. Different minds may view the situation with different degrees of probability. There are those who will believe the ship to be lost, while others will hold a contrary opinion. Nor will opinions remain fixed. The probability will vary from time to time,

In such an instance, probability is measured by the degree of belief registered in the minds of the interested parties. The rates are dependent entirely upon the mental reactions. Probability represents the state of belief in like cases, and it varies with the knowledge available. It is entirely subjective and may be entirely at variance with existing fact.

This is not to say that an attempt is made to estimate a probability without any data. The underwriter must have some knowledge of conditions; and this knowledge is drawn, first of all, from past experience and, second, from current report. Because of the bearing that current reports may have upon the underwriter's opinion of the probability of a loss, it frequently follows that rates upon the happening of a contingency vary from day to day.

The willingness of underwriters to accept risks of this sort is based, not upon their ability to give an accurate numerical value to subjective probability, but rather upon the fact that the insured overestimates his danger, thus permitting the insurer, in the long run, to name a premium in excess of the possible risk. The long-run tendency to overestimate the probability of loss in the premium charge makes such lines profitable business to the insurer.

Making a Book. There are other cases not subject to statistical inference in which the insurer may eliminate chance and yet make a profit. This is possible when he can take a position on both sides of the risk and make up a book. Following the tactics of the bookmaker handling bets at the races, he can quote an arbitrary rate on both sides of the risk, yet so arrange his commitments that he makes a profit regardless of the outcome. For example, at one time during Woodrow Wilson's first presidential campaign, Lloyd's quoted a rate of 60 per cent on a sum to pay a possible total loss of the sum insured upon Mr. Wilson's election. At the same time, 30 per cent was quoted on a sum to cover possible loss in the event of the election of Mr. Taft and 20 per cent on the election of Mr. Roosevelt. Thus, a

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and from mind to mind, depending upon the nature of the pertinent information obtainable.

In the days before swift steamships and radio communication, the reinsurance of overdue vessels "lost or not lost" was a common practice. Rates of insurance would vary from day to day. Word picked up by a passing vessel, weather conditions prevailing, signs of wreck, information as to the condition of the vessel before sailing and when last sighted, and other such bits of news would each have an effect in raising or depressing the premium asked. No amount of information, however, could alter the fact that at the moment of placing the insurance the vessel was either sunk or not sunk.

broker who would place an equal amount of insurance in the case of each individual would have but one loss to pay, for but one could be elected, yet he would collect in premiums a sum equal to 110 per cent of the loss. In this way a profit of 10 per cent was assured, and the risks were assumed for three insureds and reduced to a certainty for the insurer.

In cases of this kind, to keep the transaction within the definition of insurance the person named as insured in the contract must be in a position to suffer a loss if the contingency insured against happens. Lloyd's or any other responsible insurance organization will refuse to issue such policies unless the insured actually has an insurable interest in the event or undertaking covered by the policy. The element of insurable interest takes such contracts out of the category of gambling, and hence they are legitimate risks for Lloyd's or any other insurer willing to write them.

The Principle of Nonsufficient Reason. The operation of judgment in predicting probabilities finds an important place in the field of insurance. The principle of nonsufficient reason, also termed the "principle of indifference," is called into play for the purpose of aiding in determining which of two possible conclusions is the more probable.

Insurance is frequently placed to pay an indemnity in the event of failure of some particular venture. For example, an attempt is to be made by a young woman to swim the English Channel. Failure on her part will involve a considerable loss. What are the probabilities of success or failure? A runner is to train for an athletic contest. Failure to win will involve loss. An experimental flight is contemplated. The backers wish to insure expenses. In these and similar undertakings there is no statistical information upon which to base probabilities. Yet upon the basis of evidence obtainable, applying the rule laid down by the principle of indifference, probabilities may be determined.

According to this rule, after the elimination of irrelevant evidence, if remaining evidence favors equally each of two possible outcomes, their probabilities are equal. If, however, additional relevant evidence is brought to light, then the outcome under consideration is more probable or less probable, depending upon whether the additional evidence is favorable or otherwise.

Concerning the outcome of any event under consideration, con-

siderable relevant evidence is ordinarily available. Take, for example, the case of a young woman who contemplates swimming the English Channel. We seek to learn how many times it has been done previously, the ability of the person in question, and every other pertinent fact. Favorable reports from training headquarters would tend to make the outcome increasingly probable. A report of a developed susceptibility to cramping of the muscles would reflect in the opposite direction. When all the evidence is accumulated and the favorable balanced against the unfavorable, an estimate of the probable outcome of the event is possible. Only a relatively small number of isolated risks of this type find a place in the business of insurance.

Statistical Data Important. It can readily be seen that, unless accurate statistical information is available, predictions in the form of probabilities will be defective. Therefore, in each of the fields of insurance carefully compiled statistics are assembled to determine loss ratios and to accumulate experience as a basis for rate making. This work has been particularly extensive in the construction of mortality tables in the field of life insurance, and the work of the actuaries forms a basis for the entire life insurance structure.

The first steps in this direction grew out of the terror in London inspired by the Great Plague in 1562. The "sweating sickness," which caused death in a few hours, carried off thousands. Rumors then, as now, were exaggerated; and in order to maintain public morale the city authorities ordered the various parishes to issue bills of mortality. Bills of mortality were abstracts from parish registers, showing the number who had died in any parish or place during certain periods of time and sometimes containing such information as the number of baptisms and marriages. The first mortality record shows that from January 1, 1562, to January 1, 1563, there were 23,630 burials in or near London. Of the number, 20,136 deaths were caused by the plague.[8] The beginning of the weekly issuance of bills of mortality was by order of Queen Elizabeth and is placed at 1594. These bills, as a basis for later insurance calculations, had, however, a grave defect, namely, that the age at time of death was not included in the statement. For scientific computation this was unfortunate.

The government of the Netherlands in April, 1671, decided to

[8] Walford, C., *Insurance Cyclopaedia* (London: Charles and Edwin Layton, 1871), Vol. I, p. 282.

raise funds through the medium of life annuities; and in July, John DeWitt presented to it a report applying for the first time the doctrine of probabilities to the subject of life annuities. In the process of formulating his theory of annuities, DeWitt not only applied the principle of probabilities and compound discount in the ascertainment of the annuity value but also invented a mortality table, based upon a plan of equal decrements. Actual statistical data, however, were still lacking.

Bills of Mortality. The first, so far as we know, to turn his attention to an analysis of the bills of mortality was John Graunt, and his work published in 1661 constitutes one of the outstanding contributions to the science of insurance.[4] Among a large number of interesting problems considered in his work, we are interested in the mortality table which he presented. He computed that 7 men out of every 100 lived to be seventy. Out of each 100, only 1 would be alive at seventy-six, and none at eighty, while 36 would die before the age of six. He then made a table showing a record of 229,250 deaths and the cause of each. This work of Graunt's is the first semblance of a mortality table that we have.

Halley's Table. In 1692 it was learned that in the city of Breslau, in Silesia, records had been kept which showed, among other information, the age of the deceased at death. These were exactly the data for which the scientific men of the time interested in the study of life expectancy had been searching. Copies of these records were obtained for a period of five years, from 1687 to 1691.

Dr. Edmund Halley's reputation as the most brilliant mathematician of the time caused his selection as the man most competent to work with the materials thus obtained. The results of his work were published in 1693 in a paper submitted to the Royal Society under the title: "An Estimate of the degrees of the Mortality of Mankind, drawn from curious Tables of the births and funerals of the City of Breslau; with an attempt to ascertain the price of annuities upon lives." Halley assumed in his computations a stationary population and proceeded to construct his mortality table from the record of deaths, showing the diminution of the number of lives each year out of an original group. Halley's table was arranged to show in a

[4] Graunt, John, *Natural and Political Observations mentioned in the following Index, and made upon the Bills of Mortality chiefly with Reference to the Government, Religion, Trade, Growth, Air, Diseases, and the several Changes of the said City* (London, 1661).

simple form how many out of a group of 1,000 one-year-olds might be expected to survive at any subsequent year. The number of prospective survivors represented the chances of living, and the remainder, or those who were not expected to survive, the chances of death. This work of Halley's was an important contribution to the development of insurance science, and to it actuarial science is heavily indebted.

The Newer Tables. Since Halley's time, statistical data have been made increasingly available. Population tables have been compiled and the experiences of life insurance companies accumulated. Important investigations have been carried on with a view to determining the experience in the cases of special classes of insured lives. Studies have been made of risks involving different nationalities, occupations, geographic distribution, and the like. Other studies involve the classification of personal disabilities, such as unusual weights and heights. Studies of diseases have not been confined to individual case records; the researches have covered unfavorable family histories of, for example, such difficulties as cancer and insanity.

The American Experience Table. The American Experience Table of Mortality, first published in New York in 1868, is based upon mortality statistics from life insurance experience. The table was constructed and graduated by Sheppard Homans, actuary of the Mutual Life Insurance Company of New York and based primarily upon the experience of that company. The table found widespread acceptance by life insurance companies. New York adopted it as a standard, and many other states followed the example. While now generally conceded to be inaccurate, in that the mortality rate it reflects is greater than actual experience, it is still widely used as a basis for insurance calculations. Because it overestimates the death rate on the basis of present-day experience, it forms an extremely conservative basis for premium computation.

Other Mortality Tables. At the suggestion of the National Convention of Insurance Commissioners, an investigation was completed by the Actuarial Society of America and the American Institute of Actuaries with a view to comparing present-day actuarial experience with the American Experience Table. The findings were published in 1918, and the data confirmed the experience of individual companies with reference to the American Experience Table. In an

effort to secure a table that more actually represented current experience, the American Men Mortality Table was computed. As already pointed out, the American Experience Table continues to be widely used; but some companies have adopted the American Men Mortality Table, which has found a particular use as a basis for the study of company gains from favorable mortality experience.

The most recent accomplishment has been the development of a table known as the Commissioners' 1941 Standard Ordinary Mortality Table. This was prepared by a special committee working with the insurance commissioners and presented to the National Association of Insurance Commissioners on September 10, 1941. The table is based on current experience for calculating reserves, participating premiums, and nonforfeiture values. It has already been noted that the American Experience Table overestimates the death rate on the basis of present-day experience, especially in the younger ages. The new table is designed to reflect current mortality with a reasonable safety margin for adverse contingencies. The table is based upon the experience of representative life insurance companies during the past decade. Ten years was determined upon as a reasonable period on which to base experience. A longer period would tend to justify the criticism that the table was no longer descriptive of current mortality. On the other hand, it was determined that ten years was long enough to eliminate the possibility of unduly influencing the result by purely accidental fluctuations.

A committee on statistics of the National Fraternal Conference made an investigation of the mortality experience of persons insured in fraternal societies and published the findings in 1899. The table prepared as a result of this investigation is known as the National Fraternal Conference Table and has been widely used as a basis for premium charges by fraternal societies writing life insurance.

Application of Data to Property Rates. It has not been possible to apply mathematical formulae to property insurance rates with the same scientific precision that they have been used in the field of life insurance. Nevertheless, an enormous amount of work has gone into the accumulation of scientific data to be used as the basis of rate making. In the fields of fire insurance this extends to studies of every detail of construction, occupancy, protection, and exposure pertaining to different types of buildings. These data are ascertained through individual surveys by inspectors trained for the purpose.

The results of these individual surveys, coupled with surveys of individual cities and towns, together with scientific tests and researches dealing with hazardous materials, taken in consideration with fire loss experience, all enter into the final figure that becomes the insurance rate. In taking so many factors into consideration, judgment must contribute to the final determination of the rate. It is the constant aim of rate-making authorities to reduce judgment to a minimum and to predicate rates, as far as it is possible to do so, upon a purely scientific basis.

FOR REVIEW

1. X owns a house valued at $10,000. The fire insurance premium for one year is $50. Explain why the insurance company is willing to assume the burden of risk for $50.
2. In assuming risks, outline the advantages of the insurance company.
3. Of what use is the theory of probability to insurers?
4. In the field of insurance, what is the importance of statistical data?
5. Explain for the purposes of underwriting the significance of the probability of deviation from a predictable average.
6. A ship containing a valuable cargo has not been heard from following a tropical storm. The owners wish to place additional insurance "lost or not lost." In such a case are statistical data of assistance? Explain "subjective probability."
7. Describe the process of "making a book" for the purposes of insurance underwriting.
8. Describe the method of determining probabilities for the purposes of insurance underwriting when the risk to be insured is of a nature that affords no precedent whatsoever.
9. Describe the use made of statistics in the field of life insurance.
10. What is a mortality table?
11. It is stated that Lloyd's underwriters will insure against the happening of a contingency for which they have no previous data upon which to base a rate. Give an example of this type.
12. Discuss statistics as they apply to the business of fire insurance.

Chapter XI

FUNDAMENTAL DOCTRINES

Insurance Agreement a Contract. The rights and obligations of the parties to an insurance agreement are determined largely by reference to the law which governs contract. The agreement by which insurance is effected is a contract in which one party, in consideration of the payment of a specified sum, agrees to make good the losses suffered through the happening of a designated unfavorable contingency. The insurance contract need not of necessity be in writing, but as a matter of business practice such agreements are ordinarily written.

A contract has been defined as "an agreement enforceable by law." A more complete definition would include certain essentials which the law requires. Briefly stated, in addition to the offer and its acceptance, the object of the agreement must be legal, the parties must be competent, and generally a consideration is essential. A lack of any of the essential elements is fatal to the enforcement of the agreement.

Insurance Contract Personal. The insurance contract is one of indemnity, and follows the person rather than the property concerned.

We speak of "insuring property." Yet this is not the situation. Insurance actually provides indemnity in the event of a loss arising out of some undesired happening. On the face of it, it is impossible to guarantee to a person that he will not lose his possessions, or even to guarantee to replace them with like and kind. It is possible, however, and that is what is accomplished in the insurance contract, to provide for indemnification. Hence, if an individual should pay for indemnification against loss by fire in the event that a certain building should burn and subsequently sell the property without arranging with the insurer to transfer the insurance to the new owner, there would be no liability on the part of the insurer in case of fire, because there would be no loss on the part of the insured. It does not enter into the situation that the property covered in the policy was destroyed. The measure of liability is loss to the insured, not loss of specified property.

Doctrine of Concealment. Since the contract of insurance concerns itself with risk and uncertainty, it has been established as a fundamental doctrine of insurance law that both parties to the agreement must stand on equal footing. This doctrine makes mandatory the affirmative disclosure to the second party to the agreement of all material facts which are the exclusive knowledge of one of the parties. For example, if there is knowledge on the part of the owner that the property insured was at the inception of the agreement in grave danger of destruction, and if this information is not disclosed to the insurer, an unbalanced agreement will result. The element of chance, concerning which the parties contract, is not the same for both.

The earliest development of the doctrine of concealment was in connection with marine insurance, and in this branch today this doctrine has yielded least to modification. Eminent insurance authorities agree that a concealment of a material fact need not be intentional or fraudulent in order to void the policy, and that it is no defense to plead mistake, accident, forgetfulness, or inadvertence. If the insurer, in possession of all the facts, would have declined the risk or accepted it upon different terms, then, even though no intent to deceive was present, there are grounds for voiding the policy.

That this strict interpretation of the doctrine persists in marine insurance is, in part at least, due to the nature of the business. A ship or cargo may be insured in London, New York, or other insurance or business center; yet the insured property may be located in some far corner of the globe. More often than not, the property is beyond the possibility of inspection by the insurer. Hence full reliance and dependence must be placed upon the insured for all pertinent facts. If, as a result of ignorance, mistake, inadvertence, accident, forgetfulness, or other cause, the pertinent and material facts are not put into the hands of the insurer, the full responsibility for the failure rests upon the insured and the insurer may save himself from loss through voiding the policy.

A Modified Doctrine. In the case of fire insurance, a new situation is presented. The property insured is ordinarily convenient for inspection, and consequently those material facts essential for an appraisal of the risk are within the range of the insurer's observation. The older doctrine, still the rule in marine insurance, obligated the insured, even in the absence of inquiry, to disclose every material

fact within his knowledge. The modified doctrine, as generally adopted by the courts with reference to policies of fire insurance, adopts the view that, when it is not made the subject of express inquiry, the concealment must be intentional to void the policy. It has been held, therefore, that the insured needs only to answer fully and in good faith all inquiries made by the insurer. One exception to the rule provides that when there are unusual and extraordinary facts bearing on the risk, which facts are such as would not ordinarily be anticipated for inquiry or readily discovered by the insurer, the obligation for affirmative disclosure is present, whether or not express inquiry has been made.

Warranties and Representations. A representation is a statement made by the insured to the insurer at the time of, or previous to, the formation of the contract. Since it is the right of the insurer to have a full knowledge of the subject of insurance, it frequently becomes necessary for him to depend upon statements of the insured, from whom it is most convenient to ascertain the pertinent facts. A misrepresentation on the part of the insured of any material fact has the same effect as a concealment and affords a basis for a rescission of the contract by the insurer.

The difference between concealment and misrepresentation may be readily seen. The insured is said to conceal if he maintains a silence when obligated to speak; to misrepresent, if he makes a statement which is not in coincidence with the facts. While concealment must be conscious, wilful, or intentional, at least so far as fire insurance is concerned, in order to affect the policy, misrepresentation resulting from negligence, mistake, or oversight furnishes grounds for voiding the insurance if concerned with a fact which materially affects the risk.

To avoid the necessity of showing in a particular case whether a fact is material or not, the insurer not infrequently makes it a provision of the policy that all representations shall be deemed warranties. When such a provision is incorporated in the policy, it has been held that the application for the insurance is made a part of the policy and that the answers to specific questions on the application are deemed warranties which, if false, void the policy.

The difference between a warranty and a representation is found in the fact that a waranty is a part of the contract itself and must therefore be strictly complied with, while a representation is an

incidental statement preceding the contract and not actually a part of it, though it may be an inducement to it.

In respect to insurance, warranties are classed as either affirmative or promissory. Those in the first group relate to representations made prior to, or contemporaneous with, the issuance of the policy. The warranties that are included in the second group concern themselves with things agreed to be done or conditions to be maintained during the life of the policy. It is stated that a breach of an affirmative warranty prevents the insurance from operating, while a breach of a promissory warranty renders the policy voidable.

It is now held that a statement, in order to constitute a warranty, not only must be intended as such but must be definitely indicated as a warranty either through its incorporation into the policy or its being specifically referred to as such. Where there is any doubt as to whether or not a warranty was intended, the statement is to be regarded as a representation and must be shown to be material in order to defeat the policy.

Several states have by legislative act modified the strict application of the doctrine of warranties. Such statutes have been enacted in Maine, Michigan, Missouri, New Hampshire, North Carolina, Ohio, and Oklahoma. Where the doctrine has been thus modified, the insurance is voided only if a loss occurs during a breach or is caused thereby, or if the breach materially increases the risk. It is, however, wise not to tamper with warranties incorporated in insurance policies but to comply with them to the letter, for it is still the tendency of the courts in most jurisdictions to enforce the original strict rule, declaring the policy void when a warranty is breached, regardless of how trivial or immaterial to the loss it may be.

To this end, however, an important point is to be noted in the responsibility of an agent in correctly recording warranties or representations. An insured has every right to expect that a company representative will be both accurate and honest, and if he answers correctly the questions asked him, he is not bound to check the agent to see that they are accurately recorded as given. Hence, if a life insurance agent were to ask an applicant if he had been recently treated by a physician, and if so for what, and were to be answered "Yes, for heart trouble," the prospect would have complied fully with his obligation if this were a true answer. If, now, the agent were unscrupulous, and knowing that such an answer might cause the appli-

cation to be rejected, he were to ignore the answer and fill in the blank with the word "No," the applicant would not be responsible for the misstatement. Of course, if the insured knew of the fraud being practiced by the agent, he would become a party to it. But lacking this knowledge, even though he signs the application after it is made out, he is not to be held, for he has a right to assume that the agent of the company acted honestly and in its best interests. Thus, it has been held that any loss growing out of the dishonesty of an agent must be assumed by the company rather than be placed upon an innocent insured.

Subrogation. At common law it is held that a person who causes a loss, or who is primarily liable, ought ultimately to be made responsible for the damages sustained. In connection with the law of insurance, it is a matter of equity that the insurer, upon paying the insured the amount of the loss of the property insured, has a right of action against the person responsible for the loss equal to that held by the insured. The right of the insurer against such persons, it is stated, does not rest upon any contractual relationship but arises out of the nature of the contract of insurance as one of indemnity. It is felt that, if the insured is indemnified, it is inequitable for him to proceed upon any rights he may have had to collect from the parties responsible for the loss, since such rights as he had now belong to the insurer.

Briefly stated, the doctrine of subrogation gives the insurer whatever rights the insured possessed against responsible third parties. The rights to which the insurer is entitled are those that exist at the time of the loss. From the time of the loss the insured is bound to maintain his position as it then existed and may not release or in any other way alienate without their consent any rights that might prove beneficial to the insurers.

Waiver and Estoppel. One of the most perplexing doctrines in the entire field of insurance concerns the questions of waiver and estoppel. The problem is centered around the permissibility of introducing oral evidence to modify or contradict the terms of an insurance contract, or the subsequent modification of the contract by some action of one or both of the parties.

Estoppel prevents one from alleging or denying a fact the contrary of which by his own previous action he has admitted. For example, if an individual, owning a property built on leased land, were

to go to an agent who knew well the facts and order his property insured, and in payment of his premium secure a policy with the condition voiding the contract unless the ownership were sole and unconditional, the doctrine of estoppel would operate. The agent had led the insured to believe that his policy was valid and the insurance effective; therefore, he would be estopped from denying liability on the contract on the ground of noncompliance with the condition of sole ownership.

"Waiver" is defined as the waiving or intentional relinquishing of a known right. The knowledge of an agent is presumed to be the knowledge of the principal or, in the case of an insurance agent, the company. An agent who issues a policy in which he knows the conditions are being violated is said to waive those conditions.

Operation of Waiver and Estoppel. Writers in their consideration of waiver and estoppel ordinarily recognize three periods in which there are some differences in the operation of the doctrines and their effects. They are briefly stated as follows:

1. Period of negotiation, and up to and including the time of the delivery of the contract.
2. Period from the delivery of the contract until the time of the loss.
3. Period from the occurrence of the loss through the time covering all subsequent negotiations.

From a preponderance of opinion expressed by the courts of the various states, it is generally conceded that any knowledge in the possession of the company at the inception of the policy contract will be sufficient grounds for estopping the company in later presenting the facts at the time known as a defense of a claim under the policy. It is held, for example, that if a company with full knowledge of the facts were to issue a policy that was unenforceable, that company would be guilty of fraud. The condition that might otherwise void the policy is presumed to be waived.

The second period concerns itself with the operation of the doctrines during the interval between the delivery of the contract and the happening of the loss. In this period it has been held by some that, if knowledge of the violation of a policy condition comes to an agent, he is obligated to cancel the policy; failing to do so, he waives the violation, and the company is therefore estopped from setting up the violation as a defense in denying liability. Again, it is generally

held that if an agent with knowledge of a violation of a policy condition were to collect a premium he would have waived the violation, and therefore the company would be estopped from setting it up as a defense. This conclusion is based upon the reasoning that a company would accept a premium on a policy which it knew to be void only with the intention of treating it thereafter as valid. Finally, an endorsement on a policy by an agent who had knowledge of the violation of a policy condition at the time the endorsement was made is effective as a waiver of the violation and has the same effect as knowledge at the inception of the contract.

The final period, beginning with the occurrence of the loss and carrying through the subsequent negotiations, is regarded by company representatives as the most difficult and confusing to handle. For example, it is held that grounds for a waiver of a defense have been established if a company with knowledge of a defense asks an insured to pay a premium or file proofs. A denial of liability under a policy waives the conditions of the policy as to filing proofs and gives the insured an immediate right of action on the policy. In fact, almost any act taken by the representative of a company toward the ascertaining of the amount of the loss and its adjustment may be construed as the waiver of a known violation of a policy condition. Adjusters are bound to act with extreme caution in such instances, and to give all parties greater freedom and latitude in their actions, when there is a possibility that liability may be denied because of a policy condition, it is not uncommon for the parties at interest to sign a nonwaiver agreement. This agreement is for the purpose of relieving the company of waiving any right or acknowledging liability through any act, statement, or deed of its representative in the capacity of adjuster during the preliminary negotiations of investigating and ascertaining the loss.

Presumption of Intent. The law holds a person to be bound by the terms of a written contract which he signs or accepts, regardless of whether or not he has taken the trouble and pains to acquaint himself with all its terms and conditions.

Too many insurance contracts are complicated and difficult to understand. It is probably safe to state that, regardless of the clarity or obscurity of the terminology, more people do not, than do, read their policies. The insured assumes that the policy meets his needs and lets it go at that. It is no defense, however, when the loss occurs,

to claim ignorance of the terms of the policy because of failure to read the agreement. Summarizing a line of decisions, the court said in the case of *Grace* v. *Adams* (100 Mass. 505): "It has often been decided that one who accepts a contract and proceeds to avail himself of its provisions is bound by the stipulations and conditions expressed in it whether he reads them or not."

In connection with the insurance contract, the question of admissibility of parole evidence frequently presents itself. The rule of law applying to parole evidence has thus been expressed in a leading case: "It is a fundamental rule, in courts both of law and equity, that parole contemporaneous evidence is inadmissible to contradict or vary the terms of a valid written instrument."[1] To the same end, the distinguished insurance authority Richards, referring to the policy of insurance as best evidence, states: "In the absence of fraud or mutual mistake the written contract, if there be one, is the best and only admissible evidence of what the contract is as to all matters which it purports to cover."[2] From the foregoing it is at once evident that, while the contract in the ordinary course is not subject to modification by parole evidence, the language of the policy is nevertheless not binding in clear cases of mutual mistake of fact or where there is a mistake on one side and fraud inducing it on the other. In instances in which fraud or mutual mistake enters into the transaction, the injured party has relief in equity and may ask that the written contract be reformed to correspond to the real agreement.[3] The effect of waiver and estoppel upon the operation of the insurance contract has already been noticed; and this in so many instances has the effect of varying the terms of the written instrument that a literal interpretation of the instrument, it is sometimes said, is the exception rather than the rule. This seems an overstrong statement. In securing a contract the insured should satisfy himself that its literal terms provide the coverage he requires. On the other hand, it is well to know under what circumstances relief is available when the written contract is not in fact a statement of the actual agreement.

In connection with the insurance policy, questions sometimes present themselves as to the interpretation of the terms. If the lan-

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[1] *Northern Assurance Co.* v. *Grand View Building Assn.*, 183 U.S. 308 (1902).

[2] Richards, G., *Law of Insurance* (4th ed.; New York: Baker, Voorhis & Co., 1932), p. 105.

[3] *Ibid.*, p. 107.

guage of the policy is ambiguous, parole evidence may be introduced to explain the real meaning intended by the parties to the agreement. As to whether or not the contract is ambiguous is a matter for a court to determine. In construing an ambiguous contract the courts undertake to set up a construction in line with the apparent intent expressed in the policy. Because policies are usually prepared by the insurance company and offered to the insured in printed form, it is held that the insurance company is in a more favorable position than the insured in that the company itself prepared the agreement. To this end, it is customary when courts are called upon to assist in arriving at the meaning of an insurance contract to apply the maxim of insurance law, "The words of the instrument are construed strongly against the one who drafts them." The insured, since in the ordinary course he has no part in the preparation of the policy, is protected to the extent that the contract, without distorting its terms, is expected to be fair and reasonable and to provide reasonable protection. The rule has been thus expressed:

> No rule of interpretation of an insurance contract is more firmly imbedded than that which declares that where the language of the policy is without violence susceptible of two interpretations, one of which being that contended for by the insured, it should be most strongly construed against the insurer for the language is that of the insurer.[4]

From the foregoing it is apparent that the terms of the policy govern in the absence of fraud or mistake, or unless for some reason the insurance company has waived a defense or is estopped from asserting it. In cases of ambiguity or doubt it is not presumed that the terms of the contract are changed. The parties may have resort to the courts, and the courts in turn attempt a fair and reasonable interpretation. When the language of the contract permits two interpretations, one favoring the insurer and the other the insured, as between the insurer and the insured the courts will construe the contract against the insurer.

Agency. With the development of modern large-scale enterprises, much of the business of the day must be entrusted to representatives. In the case of corporations this is particularly true. There is little, indeed, that a corporation is able to accomplish except through the medium of representative agents. Since the major part of the insurance business is in the hands of corporate organizations, it is at

[4] *Ibid.*, p. 115.

once apparent that in this field the part played by the agent is no unimportant one.

Agency involves three parties. The first is known as the "principal." When a principal authorizes a second party to create, to modify, or to terminate contractual relations between himself and a third party, an agency relationship has been created. It is stated, as a general rule, that anyone who may act for himself may also act as an agent, though contracts which delegate authority to an agent must, like other forms of agreement, have as their purpose a legal object.

Appointment of Agent. In the creation of an agency relationship it is the custom of the principal expressly to confer definite and certain authority upon the agent. This is the custom in the business of insurance. A carefully drawn document, frequently termed a "commission of authority," designates the parties and outlines the authority of the agent to act for the company. The commission is frequently in the form of a large engraved certificate which is framed and hung in a conspicuous position in the business office of the agent.

To create an agency relationship, it is not necessary that the agreement be reduced to writing. As a matter of fact, no particular formalities are essential, and the authorization may be written or oral. To the general rule, however, there are exceptions. One of these is of particular concern in the case of an agent authorized to write surety bonds. It is a rule that, when the purpose of the agency can be fulfilled only by the signing of a formal document under seal, the agency must be created under seal. The agent is then said to possess the "power of attorney."

Agency by Estoppel. Unless a principal has in some way taken steps in the creation of an agency relationship, ordinarily there is no agency. It is true, however, that a principal may by his conduct be estopped from denying the existence of the agency. If the principal permits one holding himself out to be an agent to act in such a way that third parties may reasonably believe that an agency relationship exists, and if a third party relies upon the attitude of the principal, the principal will be estopped from denying the existence of an agency. The agency thus created is said to be an agency by estoppel, and to the agency the term "ostensible" is applied.

The application of this principle to insurance may be thus illustrated: Suppose an agent is suspended by the company, and the company's representative undertakes to secure the commission of

authority, blank policies, and other supplies. For some policies that have been lost or mislaid a receipt is taken from the agent with a statement that the policies have never been issued to his knowledge. Should the suspended agent later find and issue a lost or misplaced policy, he will have acted after the termination of his authority and after he had been deprived of his powers as an agent to assume risks or issue policies. But, since he had the forms and policies in his possession, it would be manifestly unfair to an innocent third party, who in good faith bought and paid for the insurance, to have the company deny liability on the ground that the agent had lacked authority. In such a case, the company will be estopped from setting up lack of authority as a defense, and it will be bound on the policy.

Agency by Ratification. It sometimes happens that an agent may hold himself out as having authority whereas, as a matter of fact, he has no authority to act for a given principal. Contracts entered into between one presumed to be an agent and a third party, when the agent is without authority and there is no element of estoppel, are without effect to bind the supposed principal. If, however, the principal ratifies the act of the unauthorized agent, the agreement becomes effective and binding upon the principal, not from the time of the ratification, but from the inception of the original agreement.

Ratification may be either expressed or implied from any act, expression, or conduct which would definitely indicate the intent of the principal to adopt the transaction. When definite formalities are required to grant the agency authority, such as a power of attorney to authorize an agent to sign a sealed document, these formalities are necessary in order to effect a ratification. Ordinarily, however, an expression of approval, acceptance of a benefit, promise of performance, or partial or complete performance on the part of the principal will constitute a ratification, as will the bringing of a suit based upon the agreement in question.

Finally, an agreement made by an unauthorized agent must be ratified or rejected in its entirety. It is obviously unfair for a principal to accept the benefits of an agreement, ratifying it to that extent, and yet divest himself of burdensome obligations on the ground of lack of an agent's authority.

In the field of insurance this principle is illustrated by the following situation: It often happens that an agency is suspended by the company for one reason or another. If, for example, an agent is

slow in remitting balances and the matter reaches a critical point, the company may terminate the agency and prohibit the writing of further business in its name. The act of termination may be a gesture to indicate to the agent the seriousness of his position. If while such a status exists the agent secures a very fine line of insurance and issues a policy in the name of the company that suspended him, the company will be deemed to have ratified the transaction and assumed full liability under the contract if it fails upon receipt of its copy of the policy record to demand immediate cancellation with a return of the full amount of the premium paid. Aside from the element of ratification, in this same case the principle of estoppel will likewise be operative. It is sometimes held that a principal may not ratify an unauthorized act after the risk contemplated in the agreement has passed. In the case of insurance, however, it is generally held that a company may ratify an unauthorized policy at any time, even after the occurrence of a loss.

In the case of both ratification and estoppel there is commonly said to be an "agency relationship." Strictly speaking, this is not a correct statement of the situation. No agency is actually created. A more accurate statement of the situation would be to say that through the operation of the principles of ratification and estoppel the parties involved do not create an agency, but through their acts bind themselves in the same manner as if an agency in fact actually existed. This distinction, however, has no practical application; and for ordinary purposes the terms "agency by estoppel," or "ostensible agent," and "agency by ratification" indicate the creation of a relationship in which all the rights, obligations, and liabilities of the contracting parties are protected as if an agency were created by express authority.

Secret Limitations of Agent's Authority. In connection with the law of agency the word "apparent" assumes an extremely important place. There can be no question concerning the responsibility of the principal for those acts of his agent acting in accordance with definite instructions and within the scope of the authority definitely delegated to him. It sometimes happens, however, that the limits of an agent's authority are not readily ascertainable. In such an instance, assistance may be gained from the principle that invests an agent, in addition to those powers expressly conferred, with such incidental powers as are necessary for effecting the purposes for which the agency was

created. Again, the general uses and customs of the community in which the agent is operating tend to expand or limit his authority. Ordinarily, therefore, it is sufficient to bind the principal when dealing with third parties if an agent with expressly conferred powers is acting within the scope of his apparent authority.

A principal may from time to time modify or limit the powers of his agent. As between principal and agent, the agent is bound by these limiting instructions. On the other hand, a third party having knowledge that an agency exists is under no obligation to search out and explore in order to learn the existence of uncommunicated limiting instructions. In the case of limiting instruction, when notice is given third parties, they are, of course, bound by them; but in the absence of such notice, insureds are in no way affected if in their dealings with the agent he acts within the scope of his apparent authority.

An example of the operation of this principle may be illustrated by the custom of insurance companies of issuing to their agents lists of risks which the company will not write. For example, the following coverages are included in the list of so-called "prohibited risks" of one fire insurance company: amusement park and fair ground properties; asphalt and composition roofing works; cotton gins; crossroad stores; dry kilns and evaporators; farm property; ice houses and contents; mattress factories; roadhouses and roadside stands; shoddy mills, junk, or rag risks; slaughter houses, rendering works, and glue factories. The lists vary with companies, so that some lines accepted by one company will be refused by another. Some companies are liberal in their underwriting; others, extremely conservative. It is possible, therefore, for an agent to accept a line, write the policy in a company that prohibits the risk, deliver the policy, and accept the premium. In this situation, should a loss occur before the report of the policy reached the company or cancellation had been effected, the company would have a right of action against the agent but would be bound to the third party if the latter had no knowledge that the agent lacked authority to issue the policy.

FOR REVIEW

1. Must insurance contracts be in writing?
2. X insures a dwelling against loss by fire. During the policy term the building burns. X is not the owner of the building at the time of the fire. Having accepted the premium, is the insurer liable?
3. B owns a dwelling house which he insures for $5,000. Unknown to the

insurer, he conducts a dyeing and cleaning establishment on the premises. A fire causes a total loss. Is the company justified in refusing to pay the loss on the grounds of concealment?

4. Distinguish between the application of the doctrine of concealment in marine insurance and fire insurance.
5. X insures his property, warranting to close the shutters facing a passageway nights, Sundays, and holidays. A fire occurs Sunday afternoon, caused by a carelessly discarded cigarette. Investigation shows the shutters to have been left open. This in no way contributed to the loss. Does it affect the insurance?
6. Distinguish between a "warranty" and a "representation."
7. Distinguish between "misrepresentation" and "concealment."
8. Distinguish between an "affirmative" and a "promissory" warranty.
9. X, in purchasing an insurance policy, answers all questions truthfully. The agent distorts the answers in filling the application. Without reading the application X signs it. After the loss the company denies liability on the ground of misrepresentation, contending that the insured should have read the application before signing and that the agent filled it out only as an accommodation. What is your opinion?
10. After a loss X learns that his policy covers his dwelling but not his garage. He contends that it was always his understanding that all the buildings on the premises were covered. Has he grounds for a claim for a loss to the garage?
11. B, an agent, is suspended by the Blank Company. The company representative takes its supplies from B's office. B reissues an expired policy, collecting and retaining the premium. Is there any liability on the part of the company for which the agent purports to act, or must the policyholder suffer the loss?
12. In the foregoing situation, after suspension but before the supplies are taken up, B issues a policy carrying a large premium. He is without authority to do this but reports the policy to the company in due course. The company accepts the premium. Upon what theory is the agent's act validated?
13. X, an agent, has instructions not to insure certain prohibited properties. Carelessly, an employee of the agent issues a policy on a prohibited risk. Before notice reaches the home office of the company the property burns. Discuss the questions of liability involved.
14. B, an agent, signs a contractor's bond for $1,000,000. His authority permits him to issue bonds up to and including $50,000. The bonding company denies liability. What is your opinion of its position?
15. X is an insurance agent and, in soliciting a line on a dwelling house, takes the data as to ownership from a deed which is shown him. He makes a mistake and writes the policy in the name of the husband when, as a matter of fact, title is in the wife. Neither husband nor wife has in any way contributed to the mistake. A fire occurs and the company denies liability. May the husband collect in this case?

16. B is a solicitor for the X insurance company. In attempting to sell fire insurance how is an offer and acceptance made so that a legal agreement is effected? Who makes the offer and who makes the acceptance?
17. B takes out an insurance policy covering goods involved in a smuggling operation. Under the terms of the contract, if the goods are lost "from any cause whatsoever" the company is liable. It was the intent that the coverage extend to indemnify the owners if the goods were lost to them through seizure by customs officials. After a loss because of such seizure the company refuses to pay. What is the position of the insurers?
18. In order to avoid the implications of waiver as the doctrine applies to the business of insurance, a so-called "antiwaiver clause" is sometimes incorporated in insurance policies and reads in the following general terms: "No one shall have power to waive any provision or condition of this policy except such as by terms of this policy may be subject of agreement added hereto, nor shall any provision or condition of this policy or any forfeiture be held to be waived by any requirement, act or proceeding on the part of this Company relating to appraisal or to any examination herein provided for; nor shall any provision or permission affecting the insurance hereunder exist or be claimed by the insured unless granted herein or by rider added hereto." Why is waiver a problem if a clause of this sort may be used?
19. X approaches the Blank agency for $10,000 insurance on his dwelling. The agent states the insurance is bound; and before he can get to enter the facts upon his binder, his mind is diverted and he completely forgets the matter. It is next brought to his attention a few days later by X who reports a serious fire. What is the position of X, and what is the position of the Blank agency? Which of his companies, if any, are liable?
20. The fire insurance contract in the ordinary course is signed by the agent, though sometimes forms and clauses are signed with a rubber stamp. What do you think of this practice?
21. X, an insurance agent, in connection with his other duties serves as a special agent for one of his fire insurance companies. His duties as special agent take him away from the office for considerable periods of time. He, therefore, has instructed his secretary to sign policies for him in his absence. You have received a policy with the agent's name signed to it, but you recognize that it is not his signature. X's secretary indicates that she has been authorized to sign in his absence. Does the agent have a right to delegate by power of attorney his authority to sign?
22. In the foregoing case, if the policy were delivered to the insured without any knowledge on the part of the insured that the signature was not that of the agent, would it make any difference?
23. If the signature had been attached by a rubber stamp either by an agent or by one of his employees instructed to attach the signature, what would the situation be as to the legality of the policy?
24. X, an agent, has his secretary prepare a policy written in his own agency and covering on his own dwelling. This policy is to renew a policy expiring within a week. Before X gets to sign the policy he is killed in an automobile

accident, and in the pressure of other things his heirs allow the policy on his house to expire and the new policy remains in the file unsigned. A loss occurs, and X's estate undertakes to collect. What is the position of the estate?

25. X is ordered by telephone to write a policy for $20,000 on his dwelling and name the First National Bank as mortgagee. The policy is issued for $5,000 and the name of the Second National Bank is inserted as mortgagee, but the policy is in fact delivered as directed to the First National Bank. A loss occurs and the insured contends an error has been made and his policy should be rewritten as it was ordered. Entirely aside from what may be good business practice, what are the legal rights of the parties?

CHAPTER XII

REINSURANCE

DEFINITION. "Reinsurance" is the transfer of insurance business from one insurance company to another. The company transferring the business is termed the "ceding company," while the company to which the business has been transferred is designated the "reinsurer." Under the reinsurance contract the reinsurer assumes all or part of the liability contracted for by the ceding company through the direct writing of a policy. There is no direct relationship between the insured under the direct policy covering the risk and the reinsurer, whose contract is with the ceding company alone. The contract between the insured and the direct-writing company is one agreement. The contract reinsuring the risk is another, in which, following the general rule, the original insured has neither interest nor rights. As in the case of other insurance, the contract is one of indemnity, in which the ceding company is the insured and the reinsurer is the insurance carrier or insurer.

Under the strict contract of indemnity, the reinsured is obligated to pay only the ceding company upon payment of the loss by that company to its policyholder or to the claimant. In the event of the insolvency of the ceding company, resulting in inability to pay the loss, the reinsurer would thus escape liability. Even if the reinsurer is liable, it does not necessarily follow that the amount of the liability will ultimately be paid to the claimant who suffered a loss, but rather the amount may become a part of the general assets of the bankrupt company. A recent trend favors a reinsurance contract obligating the reinsurer to pay its share of a loss direct to the reinsured policyholder instead of to the receivers of the ceding company. Such contracts, and legislative action requiring them, are in the public interest.

Reinsurance performs an important function in distributing risk. The practice is common and the business highly developed. While much of the reinsurance business is an exchange between direct-writing companies, there are in addition a number of companies whose business is exclusively reinsurance. By means of adequate reinsurance facilities, direct-writing insurance companies are enabled to ad-

just themselves to the present-day demands for coverage without violating the principles of sound underwriting.

Agency Reinsurance. Entirely apart from reinsurance for underwriting purposes, the custom is growing of issuing to the insured a single policy covering his entire risk and reinsuring the policy so delivered in the office of the agent. Insureds, in the interest of simplicity, sometimes demand a single policy, or a very few policies, to cover a risk. On the other hand, in an effort to render the insured a service and secure his business, agents sometimes suggest the plan.

Agency reinsurance is effected by writing a single policy on a line in the agency producing the business. This policy is delivered to the insured. The agent in turn writes one or several policies assuming part of the risk covered by the policy delivered to the insured. These policies are written in the name of, and delivered to, the insurance company whose policy has been delivered to the insured. To illustrate: The X department store insures its merchandise for $1,000,000. For the purposes of convenience the insured asks for one policy. The agent writes one policy in A company for $1,000,000 in the name of X. Knowing that A company will be unwilling to write $1,000,000 on this line without reinsurance, and because he knows his other companies would be glad to have part of the line, he writes policies in companies B, C, D, E, F, G, H, I, and J, each for $100,000 reinsuring company A. This transaction results in a net liability on the merchandise of X of $100,000 in ten separate companies and at the same time affords X the convenience of a single policy. The entire transaction is handled by the agent. The companies in turn, however, may further reinsure the lines allocated to them if they elect to do so.

Under the plan, the direct-writing company, that is, company A in the foregoing example, is responsible to the insured for the full face of the policy. In the event of a loss, the direct-writing company settles with the insured and the insured usually does not have any knowledge of the reinsurance. The reinsurance indemnifies the direct-writing company in accordance with the terms of the reinsuring policy. Because it is impossible for an agent to represent two principles when their interests are conflicting, consent of the companies concerned is necessary in effecting agency reinsurance. This consent often takes the form of a ratification of the agreement, following the issue of the reinsurance contract.

That the issuing of one or a few policies tends to simplicity goes

without saying. There is little more to commend the plan, and the insured should be fully cognizant of all the consequences of the transaction. In the first place, the insured loses direct contact with all but one, or a few, of his insurers. It is not at all unusual for an insurance company to make a payment on a loss when, if the policy is strictly interpreted, there is no liability under the contract. Such payments are termed "*ex gratia* payments" and are made to maintain goodwill, avoid the unfavorable publicity of a suit, or for similar reason. *Ex gratia* payments made by the direct writing company can under no circumstances be legally collected from the reinsurer. It follows that the direct writing company will be less willing to assume the full burden of an *ex gratia* payment than it will to pay its proportionate part. By the same reasoning, the reinsurer will be less willing to assume voluntarily a proportionate part of such a payment without benefit of goodwill than would be the case in the event the business had been directly placed.

Again, as has already been noted, the original insured may have no rights under the reinsurance contract or any claim whatsoever against the reinsurer. The seriousness of the situation to which this principle gives rise is at once apparent when it is recognized that in the event of the insolvency of the direct-writing company, the insured has no right of action against the reinsurers of his own risk; nor will the receiver of the insolvent company set aside for the benefit of the insured any sums collected because of a particular loss. The sums thus received become part of the assets of the direct writing company and are distributed in accordance with the law, without regard to the claimant through whose loss the liability for the payment originated.

In short, when an insured asks for a single policy for his own convenience, he virtually violates a fundamental canon of risk bearing by placing all of his eggs in one basket. The situation is the opposite of that in which the insured divides his business among a number of companies, who in turn reinsure their excess liability in the interest of safe underwriting. The risk is divided by the insured, and any reinsurance effected only serves to subdivide it further. The insured has many direct contacts instead of one, and competition will require all direct writing companies to do within reasonable limits what one is willing to do.

Portfolio Reinsurances. When a company retires from an agency or from a territory, the company may find it desirable to terminate

the liability still outstanding on its unexpired policies. This it does by means of a reinsurance contract under whose terms the outstanding liability is assumed by the reinsuring company. Because in such an instance a large number of individual risks are concerned and the liability is transferred by means of a single transaction, the form is termed "portfolio reinsurance."

This form is likewise used when a company desires to retire from business or a particular branch of business or is forced to suspend coverage because of insolvency. Thus, if a company should find the accident and health branch of its business to be unprofitable, it might decide to withdraw from that branch. In order to save the expense of maintaining a department to carry on until the outstanding policies expired, it would seem more desirable to transfer in a group all outstanding lines. In the event of financial difficulties, the reserve is used to reinsure the risk. If the stockholders of a company wish to discontinue business, they must first dispose of outstanding liabilities. In these instances portfolio reinsurance serves to effect the transfer in a single transaction.

There are cases under portfolio reinsurance held to be exceptions to the general rule that the original insured has no rights under the reinsurance contract. Decisions have been made that the original insured might sue the reinsuring company when the entire business of a company has been transferred to another.

Reinsurance for Underwriting. Reinsurance effected by agencies represents but an occasional use of the principle. As an underwriting aid to insurance companies it has become an important factor. An insurance company may receive a risk from its agent in a given locality and for one or more reasons deem it inadvisable either to cancel the risk or to assume the entire liability. In such a case it resorts to the relief offered through the facilities of reinsurance. Reasons for which a company might wish to limit its liability on a line would include: (*a*) intrinsic undesirability; (*b*) line too large; (*c*) surplus readjustment; (*d*) concentration in conflagration center.

Intrinsically Undesirable Risks. A risk, because of its inherent characteristics, may be one that prompts cancellation on the part of the underwriter. Its undesirability may be due to the construction or occupancy of the building, to an element of moral hazard which may be present through negligence, to its situation in an unfavorable location, or to some other adverse circumstance. While it is the first

impulse of the underwriter to order cancellation of such a policy, consideration of the agency accepting the risk often influences his decision otherwise. The term "accommodation" is given to such a line because it is accepted, not on its merit, but to accommodate an agent from whom a profitable business is ordinarily forthcoming.

An example of an accommodation line is a hazardous risk owned by an insured who likewise places a large amount of desirable business. The agent cannot expect to write the preferred line and reject the hazardous risk. Nor can a company expect a fair volume of that same agent's desirable business if it refuses to recognize this type of situation and share with the other companies of the agency in assuming the less desirable lines. When the nature of the case is one that virtually requires the company to retain such a line in spite of judgment to the contrary, reinsurance affords a means for reducing the risk.

Excess Lines. It is essential for the prediction of losses within a reasonable degree of certainty that there be a wide dispersion of risks, and the amounts to be carried on each location must be approximately the same. If risk is concentrated in large amounts on a few properties, obviously the variation from the average may and probably will be great. For this reason, the insurance underwriter seeks to limit his lines and secure the widest possible dispersion of risks.

The obvious way to accomplish this distribution might seem to be to limit the amount to be carried on a class and to accept only that amount from the agent. The exigencies of business, however, have given rise to another procedure. The insurance agent secures his income through placing the business he is able to obtain. If the companies he represents cannot carry the occasional big line he has to offer he will naturally look for other companies. Additional companies, added to the agency, will mean also a distribution with them of desirable business adequately provided for. The companies, therefore, accept larger lines than they themselves wish to carry and then relieve themselves of this excess liability through the agency of reinsurance.

Finally, it is not at all uncommon in business transactions today to require insurance immediately in large amounts. Merchants and manufacturers frequently import or ship goods in amounts valued in excess of a million dollars. It would be a serious inconvenience to be obliged to shop about in an effort to divide the line among a number

of companies. To effect the full coverage in a single transaction simplifies the procedure and expedites business.

Surplus Readjustment. The amount of risk which a company may at any time carry is dependent upon its capital and surplus account. The laws of the various states make mandatory a minimum reserve for all outstanding risk. In the event that a company, through excessive losses or for any other reason, should find itself in an overextended position, it may resort to the expedient of reinsurance to relieve itself of part of the burden.

Concentration in Conflagration Center. Somewhat akin to the foregoing is the accumulation of risk in a conflagration area. Every insurance office maintains, in the cities in which it writes business, records of the areas subject to a single fire. Such an area may cover a large section of the city or only a block or two. It may be a row of old buildings, a frame section, a dwelling area of frame construction with combustible roofs, or an area exposed to some unusual hazard.

A company may secure, often from different sources, a number of risks located in such a district. Even though the properties be entirely separate, the ownership different, and no relationship in their control, if they are situated in an area subject to a single fire, from the underwriting standpoint they are treated in the same manner as an excess line on a single risk. The company determines the net amount of risk it is willing to carry in the area and reinsures the rest.

The Net Retention. When for any reason a direct writing company desires reinsurance, the reinsurer is interested in knowing to what extent the ceding company remains interested in the risk. The remainder carried by the ceding company after all reinsurance has been placed is referred to as the "net line," or the "net retention." Since the reinsurer in most reinsurance agreements depends upon the ceding company to do the underwriting, the reinsurer would be unwilling to assume any risk which the ceding company itself refused to assume. For this reason, when reinsurance treaties are effected, a clause may be inserted stipulating that the total amount to be reinsured under the treaty shall depend upon the net retention, and it may further be stipulated that the reinsurer shall not be called upon to pay on any loss an amount in excess of that paid on the loss for its own account by the direct writing company. While some companies object to the clause as involving an excessive amount of paper work, it is recognized as a basic principle in the business of reinsurance that

the ceding company should place no liability upon the reinsuring company that it is unwilling to share.

The amount carried net by a company depends, on the one hand, upon the size and strength of the company and the premium income from the class and, on the other, the loss expectancy, based upon the type of risk. A large company enjoying a sizable premium income from the class naturally will be willing to carry net a greater line than its smaller neighbor, less favorably situated. Again, a building that is classed as a total loss risk invites a smaller net retention than a fireproof risk, termed by insurers "30 per cent subject," that is, a risk the loss upon which in a single fire will on the basis of probability be limited to 30 per cent of the value.

Forms of Reinsurance. Just as the purposes for reinsurance differ, so do the methods for effecting it. In addition to portfolio and agency reinsurances, which are in fact specific reinsurances, the principal methods in use are: (*a*) specific reinsurance; (*b*) treaty reinsurance; (*c*) excess of loss reinsurance; (*d*) retrocession.

Specific Reinsurance. "Specific reinsurance," also termed "facultative reinsurance," is a form which concerns itself with a specific transaction. It is in no way connected with other reinsurance between the companies concerned, nor is it dependent in any way upon other contracts of like nature. Each contract under specific reinsurance is written on its own merit and is a matter of individual bargaining between the parties. It is termed "facultative" because the reinsurer is under no obligation, through previous agreement or reciprocal arrangement, to accept the risk. In other words, he retains the faculty or privilege to accept or reject a line, as offered.

The procedure is simple and was, in fact, the first form of reinsurance of which we have any record. Modern practice has given rise to newer procedures; nevertheless, specific reinsurance is still widely used. Because the underwriting requirements are burdensome, few insurance companies doing only a reinsurance business write this form of coverage, and the bulk of such business is exchanged between direct-writing companies.

Treaty Reinsurance. Because in the case of specific reinsurance no liability attaches to the reinsurer until he definitely assumes it, there always is a considerable degree of uncertainty on the part of the direct-writing company as to whether it will be successful in reinsuring a line that it assumes. To overcome this and other short-

comings of the specific form, treaty reinsurance was developed.

A treaty is said to exist when two or more companies enter a contract which includes within the terms of the agreement a number of individual reinsurances that at the time of the agreement may be undetermined. Each of the companies to the treaty agrees to insure a proportionate part of a designated class of business written by the other. Or, so far as the reinsurance feature of the agreement is concerned, the contract may be unilateral; that is, one party only agrees to accept reinsurance. A treaty embraces future contracts as well as those in existence at the time the agreement is executed.

When the reinsuring company under a treaty retains the right or faculty to determine which of the risks offered it will retain, the agreement is referred to as a facultative treaty. Because the facultative treaty subjects the direct writing company to the same uncertainty concerning reinsurance facilities that exists under specific reinsurance, treaties controlling the major part of the business today obligate the reinsurer, within the limits set in the agreement, to assume the ceded lines. Obligatory treaties, as usually drawn, require the direct-writing company to cede and the reinsurer to accept such lines as are embraced by the treaty, though sometimes treaties are written permitting the direct writing company to cede only such lines as it cares to but obligating the reinsurer to accept the lines ceded.

When the reinsurer is obligated to accept a specific part of each risk assumed by the direct-writing company, and the direct-writing company on its part is obligated to cede a like portion of the risk, the liability of the reinsurer attaches as soon as the direct writing company assumes the risk. Such a treaty is termed "automatic." When the direct-writing company retains the option as to what it will reinsure, the agreement is referred to as an "open treaty." When both reinsured and reinsurer share, on an agreed percentage basis, every risk assumed directly by either, the agreement is termed a "quota share treaty." When the reinsurer is not expected to participate until the share of the coverage to be retained by the direct-writing company has been exhausted, the agreement effecting the reinsurance is termed a "surplus treaty" or "excess treaty." Most treaties today are written on the surplus basis, thereby permitting the direct-writing company to retain as much of any line as it cares to and to cede only as much of the risk as is in excess of its facilities to handle.

Surplus Treaties. Because the greater number of all obligatory

treaties in the United States are on a surplus basis, this type of agreement finds an important place in the business of insurance. Under the terms of such a treaty, the direct-writing company cedes a line only if it exceeds the determined net retention on the class. The amount of the excess or surplus is the amount ceded.

It so happens, however, that a direct writing company may secure a line whose surplus or excess will be greater than the amount of risk the reinsurer has agreed to assume. For that reason, when there is a possibility of a second excess, a second surplus treaty becomes necessary. There is, theoretically, no limit to which the number of surplus treaties may be carried. The nature of the lines accepted in most cases would probably not require a surplus treaty beyond a third. If an occasional line exhausted even these facilities, it could be cared for by specific reinsurance of the excess.

When there are several surplus treaties, it is the rule that all reinsurance in excess of the net retention shall be ceded to the reinsurer participating in the first reinsurance treaty up to its designated limit. When the line exceeds this designated limit, the ceding company is then obligated to use the company participating in the second treaty up to its limit. The procedure is followed until the line is fully reinsured by absorption through successive treaties or the final excess is reinsured on a specific basis.

Surplus treaties are made on a basis of the net retention, and not in terms of round numbers. Thus, the reinsurer under the first reinsurance treaty agrees to reinsure a line measured as a multiple of the net retention. Each multiple is termed a limit. Hence, each treaty agrees to reinsure one, two, or several limits of the line written by the ceding company.

Not infrequently, the first surplus treaty is an intercompany pool, to which the members cede their first excess line. Thereafter, through the operation of a second surplus treaty, three to five lines are accommodated, with additional lines in a third treaty if the character of the business requires it.

The system operates somewhat as follows: Assume that a line is offered a company to insure $100,000 on a risk on which the company itself is willing to carry but $5,000 net. The sum of $5,000 represents a line. If the first reinsurance treaty is an intercompany pool accepting but one line, a second $5,000 is cared for. Assume that the second surplus treaty will provide for five lines, and the third surplus

treaty affords facilities for three more. In such a situation, the company can automatically handle $50,000 on the line, and either it will decline to assume a risk in excess of $50,000 or it will carry as much more as it can effect specific reinsurance to cover.

In the same circumstance, if the building were fireproof or equipped with sprinklers, the company might be willing to retain $20,000 net. The first treaty then would take care of the next $20,000, and the second treaty would carry the entire balance. In fact, the company's facilities would allow, without resorting to specific reinsurance, nine excess lines, permitting it to accept $200,000 on a risk where its net retention was $20,000.

Excess of Loss Reinsurance. From the underwriting point of view, the reinsurance of every line tends to give a proportionately greater spread to every risk and, consequently, added stability to the business. If the company securing the business is writing a sufficient volume of business to secure an adequate distribution of risk, the reinsurance of a proportion of every line, however small, tends to complicate the business as well as to divert from the company premiums that it might well keep.

Excess of loss insurance is designed to afford protection against large losses only. This coverage is used when protection is desired either on a single risk, against a single large loss irrespective of the number of risks involved, or against an accumulation of losses in excess of a stipulated limit. The coverage may be limited to a certain area, such as a designated city, or may be nation-wide in its scope. Again, the coverage may be limited to a definite class, where a company desires to protect underwriting profits. In the last-named instance, the reinsurer obligates itself to pay all losses in a given class when the loss ratio exceeds an agreed percentage of the earned premiums.

Unlike the quota share cover, under excess of loss reinsurance, in the case of loss there is no obligation on the part of the reinsurer until the gross claim is shown to be in excess of the amount payable by the ceding company. Sometimes, in order to arrange the reinsurance in such a way as to hold the ceding company interested in the gross amount of the loss settlement, the agreement is written so that the ceding company continues to participate in the excess loss up to an agreed percentage.

Excess of loss reinsurances are usually written under a specific

contract, though treaties have sometimes been effected. This is the type of coverage by which insurers cover the catastrophe hazard. American and foreign companies accepting reinsurance write the coverage, though a substantial amount of the business goes to London Lloyd's.

Retrocession. Reinsurance enjoys no immunity from the operation of the laws governing sound underwriting practice. The reinsurer must avoid a concentration in conflagration areas and must maintain a wide distribution of its risks. Since the reinsurer may have lines ceded from a number of different sources, it is easily possible that it might find itself with an unwarranted accumulation of risk in a given locality or in a given class. To relieve itself of this unsatisfactory accumulation, the reinsurer would itself have to resort to reinsurance. The act of reinsuring any part of a reinsurance is termed retrocession.

In compensation, casualty, and life risks the reinsurer sometimes finds an unusual line offered. The amount in excess of the net retention of the direct-writing company is often far greater than the reinsurer is willing to carry. In such a case, it may prefer to accept the entire excess, and in turn seek reinsurance, retaining only as much of the line as it deems prudent.

Reinsurance Pools. The reinsurance pool partakes of the nature of a multilateral automatic treaty. It is an extension of the treaty idea to include within the scope of the agreement a number of companies, each agreeing to assume a proportionate part of every risk of a designated class written by any member of the group.

Pools are organized to handle a particular class of business which an individual company would assume only with great reluctance. For example, during both the first and second World Wars, marine insurance pools were organized to insure American shipping. Through the agency of these organizations shippers were enabled to secure adequate insurance coverage that otherwise would have been difficult, if not impossible, to obtain. In the Mississippi Valley, pools have been organized to insure cotton against flood damage and to underwrite shipments to Europe and Asia. Through the agency of a pool insurance, facilities are made available far in excess of those that an individual company, however large, could offer if it relied solely upon its own resources or the ordinarily available reinsurance facilities.

To state the matter simply, a pool operates in the following

manner: The companies which participate agree to turn into the pool all lines accepted upon classifications embraced by the agreement. The central office through which all risks assumed by the pool are cleared redistributes all lines to the participating companies on the basis of a previously agreed-upon quota. The quota share assigned to each company, among other factors, depends upon the size of the company, its resources, and the volume of business it produces. Thus, the pool itself as a unit assumes no liability but acts as an agency for the redistribution of risks of a designated class among the group.

Reinsurance through Subsidiaries. Frequently direct-writing companies give subsidiary or affiliated companies a preference in placing reinsurance. By so doing they retain the premium income within the organization. From an accounting point of view, this practice will satisfy the underwriter of each company. He studies his own risks and is satisfied in the case of each organization that he has no more at risk on a given line than he is willing to carry. But as a matter of actual fact, so far as the stockholders of the parent company are concerned, it matters little to them whether the loss is paid by one company or divided among the parent and the subsidiaries. The assets of the parent company will be affected by a depletion of the assets of the subsidiary, and in the long run the loss rests upon the parent group.

There are, of course, matters of surplus adjustment and features of accounting that make reinsurance of excess lines with subsidiaries preferable to the retention of the line in a single company. Such reinsurance, however, in the case of a catastrophe affords the group no assistance outside its own resources.

Underwriters' Agencies. While, strictly speaking, it is not reinsurance, the division of a line among two or more companies with a policy issued either in their own names or under a title adopted for the purpose partakes of so many of the characteristics of reinsurance that it is frequently classified as such. When several companies join to issue policies, as indicated above, each may assume liability for its individual share or all may be jointly and severally liable. In the latter case, while the liability of each company is indicated, the failure of one or more of the group transfers the liability to the other members.

If the liability of each company insuring the risk is direct to the

original insurer, there is, of course, no reinsurance, even though the business is entirely carried on by one company, even to the adjustment and settlement of losses. In the fire insurance business such groups are sometimes termed "underwriters' agencies." There are many such agencies operating in the United States, and while they function for other purposes than the division of risk, they afford to a considerable degree a means for effecting a satisfactory risk dispersion for the member companies.

Reinsurance Carriers. From the standpoint of the reinsurance carrier, the insurers divide themselves into two classes. First, there are companies organized to write reinsurance exclusively; second, there are direct-writing companies that also accept reinsurance.

Foreign reinsurance companies are regarded with favor, other conditions being equal, because in the event of a great conflagration the resources of the foreign nation would be sufficiently remote to be free of any upset or depression localized in this country. There is always the danger when reinsurance is effected through a direct writing company that the company itself may be heavily committed in the catastrophe area.

Prohibitive Reinsurance Legislation. Insurance commissioners in some states and other persons interested in the business of insurance have seen in reinsurance a means for the evasion of the state requirements. To prevent nonadmitted companies from writing business within the particular state, some legislatures have enacted laws penalizing admitted companies who reinsure in any nonadmitted company any risk located within the state.

In some states the legislation goes to the length of prohibiting an admitted company from either ceding or accepting reinsurance from a nonadmitted company on any risk within the limits of the state. Others permit the reinsurance but require the ceding company to maintain a reserve against the ceded risk as if it were being carried net. When reinsurance is placed with admitted companies, the ceding company is not required to maintain the usual reserve, this being provided for in the reserves of the reinsurer.

The most liberal policy permits reinsurance with nonadmitted companies on the same terms accorded admitted insurers, provided the nonadmitted reinsurer is eligible for admission. A reinsurer admitted to do business in any other state, whose standards are equal

to the requirements of the state in question, is deemed eligible for admission.

FOR REVIEW

1. All the members of a lodge are insured under an accident policy. Each year a steamboat excursion is held by the organization. From an underwriting standpoint, what is the disadvantage of a large number of insureds together on the one boat?
2. Distinguish between the use of reinsurance for agency convenience and as an aid to underwriting.
3. For the purposes of insurance underwriting, indicate the principal reasons for making use of reinsurance.
4. If a risk is undesirable for any reason, what justification is to be found in transferring part of the undesirable line to a reinsurance company?
5. In the practice of reinsurance, what is the significance of the "net retention"?
6. Distinguish between "specific reinsurance" and "treaty reinsurance."
7. Distinguish between a "facultative" and an "obligatory" treaty.
8. Distinguish between "reinsurance" and "retrocession."
9. Since reinsurance facilities are extensive, outline the necessity for the occasional organization of reinsurance pools.
10. X operates a department store with an inventory of $250,000. His insurance is divided among a number of companies with expirations scattered throughout the year. B, an agent, in an effort to secure the entire line, offers to combine the coverage and in the interest of simplicity deliver a single policy for $250,000 to the insured. Knowing this to be reinsured, what advantages and disadvantages are to be found in the agent's suggestion?
11. From the standpoint of the insurance business indicate the disadvantages of "facultative" reinsurance as compared with "treaty" reinsurance.
12. The carrier that grants or issues reinsurance coverage is known as the "reinsurer" or "reinsuring company." What is the term applied to the carrier that is reinsured?

PART II

FIRE INSURANCE

Chapter XIII

THE FIRE INSURANCE CONTRACT

Earliest Contracts Caused Confusion. The purpose of fire insurance is simple indeed. It undertakes to indemnify a named insured in the event that certain described properties should be destroyed by fire. Seemingly a proposition so simply stated might readily lend itself to a contract simply drawn, and one whose terms might be easily understood by all the parties concerned.

Such, however, was not formerly the case. No uniform form of agreement was used by the fire insurance companies in issuing their contracts, and each devised a policy form to meet its own requirements. Ordinarily the policies were prepared in the home offices of the companies, but this was not always the case. Where agents were entrusted with this responsibility, the element of incompetence made its appearance, and thereby further complicated the situation. In an effort to incorporate conditions to meet different situations, the contracts began to grow extremely cumbersome and unwieldy.

With the continued tendency to incorporate conditions and warranties, the average policy became so long and complicated as to put a satisfactory interpretation of its meaning well beyond the capacity of the average insured. In fact, it became so ponderous and bulky that even those trained in the law found it difficult to interpret.

Need for Standard Policy Recognized. As the business of fire insurance developed, it became increasingly evident, both to the companies and to the insuring public, that the lengthy, cumbersome, and ambiguous documents frequently used were creating a situation that was fast becoming intolerable to business interests. It was pointed out that a shorter document, explicit in its provisions, and fair to both insured and insurer was vitally necessary to the continued success of the business. Out of the recognition of this need developed the contract to which we now refer as a "standard policy."

An early step toward standardization was undertaken by the New York Board of Fire Underwriters, who, recognizing the chaotic state of affairs, undertook, long before the state government intervened, to draw up a policy that would be satisfactory to all parties. The board appointed a committee which, assisted by legal counsel, drew

up and presented a policy that seemed to be eminently fair and to meet fully the needs of the time. It was adopted by many of the companies represented in the board, as well as by others whose business headquarters were located in New York. However, there was no element of compulsion in its adoption. Many companies continued with their own forms as before, and even where the new form was adopted there grew up a tendency to incorporate amendments, thereby destroying such uniformity as at first had been obtained.

It became evident to insurance men, as well as to the general business world, that any decided reform, in order to be effective, must come through legislation. The need for the standard policy was recognized, but the insurance interests were fearful lest a form of contract unfavorable to themselves be made compulsory. A considerable period of argument and education elapsed before the first step was definitely made.

Fire Policies Now Standard. Massachusetts was the first state to adopt a standard policy form. In 1873, the legislature drew up a form, which it enacted into a statute, thereby introducing a new era in fire policy writing. The Massachusetts form was not well received by the insurance business. It was stated that the members of the legislature entrusted with drawing up the policy failed to secure the advice and co-operation of the insurance interests, with the result that an unsatisfactory form was developed. The form was not considered suitable for general adoption by the companies, and unless its use was enforced by law they disregarded it.

The outstanding development came in 1887, when the New York State Legislature authorized the drawing up of a new standard form and made it the only legal one for writing fire business within the state. A committee was formed and insurance operators and lawyers were invited to co-operate, the aim being to draw up a policy so good that it would satisfy not only New York, but also every other state. Clauses were painstakingly discussed, opinion everywhere was sought, and nothing was incorporated into the policy until it was agreed to be eminently fair to all parties concerned. The New York policy in its final form was favorably received by both businessmen and insurance interests, and standard forms were soon thereafter adopted by the other states.

The Situation Today. The form evolved in New York was

STIPULATIONS AND CONDITIONS

NEW YORK STANDARD FIRE POLICY, NEW YORK, 1918

Fraud, misrepresentation, etc. This entire policy shall be void if the insured has concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof; or in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether before or after a loss.

Uninsurable and Excepted property. This policy shall not cover accounts, bills, currency, deeds, evidences of debt, money, notes or securities; nor, unless specifically named hereon in writing, bullion, manuscripts, mechanical drawings, dies or patterns.

Hazards not covered. This Company shall not be liable for loss or damage caused directly or indirectly by invasion, insurrection, riot, civil war or commotion, or military or usurped power, or by order of any civil authority; or by theft; or by neglect of the insured to use all reasonable means to save and preserve the property at and after a fire or when the property is endangered by fire in neighboring premises.

This entire policy shall be void, unless otherwise provided by agreement in writing added hereto,

Ownership, etc. (a) if the interest of the insured be other than unconditional and sole ownership; or (b) if the subject of insurance be a building on ground not owned by the insured in fee simple; or (c) if, with the knowledge of the insured, foreclosure proceedings be commenced or notice given of sale of any property insured hereunder by reason of any mortgage or trust deed; or (d) if any change, other than by the death of an insured, take place in the interest, title or possession of the subject of insurance (except change of occupants without increase of hazard); or (e) if this policy be assigned before a loss.

Unless otherwise provided by agreement in writing added hereto this Company shall not be liable for loss or damage occurring

Other insurance. (a) while the insured shall have any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy; or

Increase of hazard. (b) while the hazard is increased by any means within the control or knowledge of the insured; or

Repairs, etc. (c) while mechanics are employed in building, altering or repairing the described premises beyond a period of fifteen days; or

Explosives, gas, etc. (d) while illuminating gas or vapor is generated on the described premises; or while (any usage or custom to the contrary notwithstanding) there is kept, used or allowed on the described premises fireworks, greek fire, phosphorus, explosives, benzine, gasoline, naphtha or any other petroleum product of greater inflammability than kerosene oil, gunpowder exceeding twenty-five pounds, or kerosene oil exceeding five barrels; or

Factories. (e) if the subject of insurance be a manufacturing establishment while operated in whole or in part between the hours of ten P. M. and five A. M., or while it ceases to be operated beyond a period of ten days; or

Unoccupancy. (f) while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of ten days; or

Explosion, Lightning. (g) by explosion or lightning, unless fire ensue, and, in that event, for loss or damage by fire only.

Chattel mortgage. Unless otherwise provided by agreement in writing added hereto this Company shall not be liable for loss or damage to any property insured hereunder while incumbered by a chattel mortgage, and during the time of such incumbrance this Company shall be liable only for loss or damage to any other property insured hereunder.

Fall of building. If a building, or any material part thereof, fall except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease.

Added Clauses. The extent of the application of insurance under this policy and of the contribution to be made by this Company in case of loss or damage, and any other agreement not inconsistent with or a waiver of any of the conditions or provisions of this policy, may be provided for by agreement in writing added hereto.

Waiver. No one shall have power to waive any provision or condition of this policy except such as by the terms of this policy may be the subject of agreement added hereto, nor shall any such provision or condition be held to be waived unless such waiver shall be in writing added hereto, nor shall any provision or condition of this policy or any forfeiture be held to be waived by any requirement, act or proceeding on the part of this Company relating to appraisal or to any examination herein provided for; nor shall any privilege or permission affecting the insurance hereunder exist or be claimed by the insured unless granted herein or by rider added hereto.

Cancellation of policy. This policy shall be cancelled at any time at the request of the insured, in which case the Company shall, upon demand and surrender of this policy, refund the excess of paid premium above the customary short rates for the expired time. This policy may be cancelled at any time by the Company by giving to the insured a five days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired time, which excess, if not tendered, shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered) will be refunded on demand.

Pro rata liability. This Company shall not be liable for a greater proportion of any loss or damage than the amount hereby insured shall bear to the whole insurance covering the property, whether valid or not and whether collectible or not.

Noon. The word "noon" herein means noon of standard time at the place of loss or damage.

Mortgage interests. If loss or damage is made payable, in whole or in part, to a mortgagee not named herein as the insured, this policy may be cancelled as to such interest by giving to such mortgagee a ten days' written notice of cancellation. Upon failure of the insured to render proof of loss such mortgagee shall, as if named as insured hereunder, but within sixty days after notice of such failure, render proof of loss and shall be subject to the provisions hereof as to appraisal and times of payment and of bringing suit. On payment to such mortgagee of any sum for loss or damage hereunder, if this Company shall claim that as to the mortgagor or owner, no liability existed, it shall, to the extent of such payment be subrogated to the mortgagee's right of recovery and claim upon the collateral to the mortgage debt, but without impairing the mortgagee's right to sue; or it may pay the mortgage debt and require an assignment thereof and of the mortgage. Other provisions relating to the interests and obligations of such mortgagee may be added hereto by agreement in writing.

Requirements in case of loss. The insured shall give immediate notice, in writing, to this Company, of any loss or damage, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, stating the quantity and cost of each article and the amount claimed thereon; and, the insured shall, within sixty days after the fire, unless such time is extended in writing by this Company, render to this Company a proof of loss, signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: the time and origin of the fire, the interest of the insured and of all others in the property, the cash value of each item thereof and the amount of loss or damage thereto, all incumbrances thereon, all other contracts of insurance, whether valid or not, covering any of said property, any changes in the title, use, occupation, location, possession, or exposures of said property since the issuing of this policy, by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of fire; and shall furnish a copy of all the descriptions and schedules in all policies and if required, verified plans and specifications of any building, fixtures or machinery destroyed or damaged. The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same; and, as often as may be reasonably required, shall produce for examination all books of account, bills, invoices, and other vouchers, or certified copies thereof, if originals be lost, at such reasonable time and place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made.

Appraisal. In case the insured and this Company shall fail to agree as to the amount of loss or damage, each shall, on the written demand of either, select a competent and disinterested appraiser. The appraisers shall first select a competent and disinterested umpire; and failing for fifteen days to agree upon such umpire then, on request of the insured or this Company, such umpire shall be selected by a judge of a court of record in the state in which the property insured is located. The appraisers shall then appraise the loss and damage stating separately sound value and loss or damage to each item; and failing to agree, shall submit their differences only, to the umpire. An award in writing, so itemised, of any two when filed with this Company shall determine the amount of sound value and loss or damage. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally.

Company's options. It shall be optional with this Company to take all, or any part, of the articles at the agreed or appraised value, and also to repair, rebuild, or replace the property lost or damaged with other of like kind and quality within a reasonable time, on giving notice of its intention so to do within thirty days after the receipt of the proof of loss herein required; but there can be no abandonment to this Company of any property.

Abandonment.

When loss payable. The amount of loss or damage for which this Company may be liable shall be payable sixty days after proof of loss, as herein provided, is received by this Company and ascertainment of the loss or damage is made either by agreement between the insured and this Company expressed in writing or by the filing with this Company of an award as herein provided.

Suit. No suit or action on this policy, for the recovery of any claim, shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, nor unless commenced within twelve months next after the fire.

Subrogation. This Company may require from the insured an assignment of all right of recovery against any party for loss or damage to the extent that payment therefor is made by this Company

STIPULATIONS AND CONDITIONS

NEW YORK STANDARD FIRE POLICY, NEW YORK, 1943

Concealment, fraud. This entire policy shall be void if, whether before or after a loss, the insured has wilfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

Uninsurable and excepted property. This policy shall not cover accounts, bills, currency, deeds, evidences of debt, money or securities; nor, unless specifically named hereon in writing, bullion or manuscripts.

Perils not included. This Company shall not be liable for loss by fire or other perils insured against in this policy caused, directly or indirectly, by: (a) enemy attack by armed forces, including action taken by military, naval or air forces in resisting an actual or an immediately impending enemy attack; (b) invasion; (c) insurrection; (d) rebellion; (e) revolution; (f) civil war; (g) usurped power; (h) order of any civil authority except acts of destruction at the time of and for the purpose of preventing the spread of fire, provided that such fire did not originate from any of the perils excluded by this policy; (i) neglect of the insured to use all reasonable means to save and preserve the property at and after a loss, or when the property is endangered by fire in neighboring premises; (j) nor shall this Company be liable for loss by theft.

Other Insurance. Other insurance may be prohibited or the amount of insurance may be limited by endorsement attached hereto.

Conditions suspending or restricting insurance. Unless otherwise provided in writing added hereto this Company shall not be liable for loss occurring

(a) while the hazard is increased by any means within the control or knowledge of the insured; or

(b) while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of sixty consecutive days; or

(c) as a result of explosion or riot, unless fire ensue, and in that event for loss by fire only.

Other perils or subjects. Any other peril to be insured against or subject of insurance to be covered in this policy shall be by endorsement in writing hereon or added hereto.

Added provisions. The extent of the application of insurance under this policy and of the contribution to be made by this Company in case of loss, and any other provision or agreement not inconsistent with the provisions of this policy, may be provided for in writing added hereto, but no provision may be waived except such as by the terms of this policy is subject to change.

Waiver provisions. No permission affecting this insurance shall exist, or waiver of any provision be valid, unless granted herein or expressed in writing added hereto. No provision, stipulation or forfeiture shall be held to be waived by any requirement or proceeding on the part of this Company relating to appraisal or to any examination provided for herein.

Cancellation of policy. This policy shall be cancelled at any time at the request of the insured, in which case this Company shall, upon demand and surrender of this policy, refund the excess of paid premium above the customary short rates for the expired time. This policy may be cancelled at any time by this Company by giving to the insured a five days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired time, which excess, if not tendered, shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered) will be refunded on demand.

Mortgagee interests and obligations. If loss hereunder is made payable, in whole or in part, to a designated mortgagee not named herein as the insured, such interest in this policy may be cancelled by giving to such mortgagee a ten days' written notice of cancellation.

If the insured fails to render proof of loss such mortgagee, upon notice, shall render proof of loss in the form herein specified within sixty (60) days thereafter and shall be subject to the provisions hereof relating to appraisal and time of payment and of bringing suit. If this Company shall claim that no liability existed as to the mortgagor or owner, it shall, to the extent of payment of loss to the mortgagee, be subrogated to all the mortgagee's rights of recovery, but without impairing mortgagee's right to sue; or it may pay off the mortgage debt and require an assignment thereof and of the mortgage. Other provisions relating to the interests and obligations of such mortgagee may be added hereto by agreement in writing.

Pro rata liability. This Company shall not be liable for a greater proportion of any loss than the amount hereby insured shall bear to the whole insurance covering the property against the peril involved, whether collectible or not.

Requirements in case loss occurs. The insured shall give immediate written notice to this Company of any loss, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, showing in detail quantities, costs, actual cash value and amount of loss claimed; **and within sixty days after the loss, unless such time is extended in writing by this Company, the insured shall render to this Company a proof of loss,** signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: the time and origin of the loss, the interest of the insured and of all others in the property, the actual cash value of each item thereof and the amount of loss thereto, all encumbrances thereon, all other contracts of insurance, whether valid or not, covering any of said property, any changes in the title, use, occupation, location, possession or exposures of said property since the issuing of this policy, by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of loss and whether or not it then stood on leased ground, and shall furnish a copy of all the descriptions and schedules in all policies and, if required, verified plans and specifications of any building, fixtures or machinery destroyed or damaged. The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same; and, as often as may be reasonably required, shall produce for examination all books of account, bills, invoices and other vouchers, or certified copies thereof if originals be lost, at such reasonable time and place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made.

Appraisal. In case the insured and this Company shall fail to agree as to the actual cash value or the amount of loss, then, on the written demand of either, each shall select a competent and disinterested appraiser and notify the other of the appraiser selected within twenty days of such demand. The appraisers shall first select a competent and disinterested umpire; and failing for fifteen days to agree upon such umpire, then, on request of the insured or this Company, such umpire shall be selected by a judge of a court of record in the state in which the property covered is located. The appraisers shall then appraise the loss, stating separately actual cash value and loss to each item, and, failing to agree, shall submit their differences, only, to the umpire. An award in writing, so itemized, of any two when filed with this Company shall determine the amount of actual cash value and loss. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally.

Company's options. It shall be optional with this Company to take all, or any part, of the property at the agreed or appraised value, and also to repair, rebuild or replace the property destroyed or damaged with other of like kind and quality within a reasonable time, on giving notice of its intention so to do within thirty days after the receipt of the proof of loss herein required.

Abandonment. There can be no abandonment to this Company of any property.

When loss payable. The amount of loss for which this Company may be liable shall be payable sixty days after proof of loss, as herein provided, is received by this Company and ascertainment of the loss is made either by agreement between the insured and this Company expressed in writing or by the filing with this Company of an award as herein provided.

Suit. No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, and unless commenced within twelve months next after inception of the loss.

Subrogation. This Company may require from the insured an assignment of all right of recovery against any party for loss to the extent that payment therefor is made by this Company.

deemed so satisfactory that in numerous instances it was taken over by other states in its entirety, without alteration. In other cases it was slightly altered, but in its essentials it remains unchanged.

Since its adoption in 1887, certain of the provisions of the New York policy have been nullified by the court decisions. To eliminate certain unfair or inequitable features as well as those rendered null by court decisions, the National Convention of Insurance Commissioners recommended a new standard form in 1914, which was adopted by New York State in an amended form in 1918.

The New York standard form originally adopted is often termed the "old" form to distinguish it from the form adopted in 1918 which is termed the "new" form. The policies issued in most of the states have for a great many years been almost identical with one or the other of the New York forms. Three states, Maine, New Hampshire, and Minnesota, followed the Massachusetts form, and this policy is sometimes referred to as the "New England Standard." The net result found the insurance business faced with three standard forms, the old and the new New York forms and the New England form. While all of the policies were very similar and the differences well known to insurance men, it was felt from the point of view of the buyer that the situation would be immeasurably better if a standard form could be drawn that would be acceptable in all jurisdictions. About a decade ago work was commenced with this end in view. At a meeting of the National Association of Insurance Commissioners held in 1936 it was recommended that a special committee be appointed to study the problem. A committee of five was appointed and Superintendent Pink of the New York Insurance Department was appointed chairman. As a result of a study initiated by this committee, it was found that insurance buyers, brokers, agents, and adjusters favored revision of existing policies. Insurers, as a rule, found existing forms to be adequate. The sentiment in favor of revision was found to be strongest among those closely associated with the business.

At a meeting of the commissioners held in Philadelphia in June, 1937, a tentative draft of the new policy was submitted. This was based upon the present "new" New York form. There was some thought that an entirely new contract should be drawn, but this idea was discarded in favor of modifying the already familiar contract to meet present-day needs. At a meeting of the commissioners held

in Quebec in June, 1938, a form was presented for consideration, and the interest in the revision was so great that those present felt a reasonable assurance that once the new form was recommended by the commissioners it would meet with widespread adoption.

The final outgrowth of this study was the adoption by act of the New York Legislature of the new standard policy now known as the "1943 New York Form." The form became mandatory in New York, July 1, 1943, was was soon adopted by a wide majority of the states. The new form is much simpler and considerably shorter than any of the standard forms now in use, and the policy covers lightning damage in the insurance clause as well as fire. It is so drawn as to permit the inclusion of perils other than fire and is, thereby, a step in the direction of a comprehensive policy. The language of the older forms is generally retained though a number of conditions and prohibitions that have become obsolete as the result of usage have been eliminated entirely from the policy.

When reference is made to the "standard fire policy" throughout this text the "1943 New York form" is indicated. The student, however, should be on guard in any particular instance to check the policy of the state in question to determine whether or not the 1943 New York form is standard in the area or whether one of the older standard forms is still in use.[1]

Benefits Derived from Standardization. Before the adoption by the states of a standard policy form, an insured might carefully study the conditions of one or all of his policies and be satisfied that his needs for insurance coverage were satisfactorily met. But before renewal, some happening in the insurance business might have given rise to a change in policy forms, and when the new policies were delivered some obscure change in wording might have materially altered the coverage. Eternal vigilance, therefore, was necessary in order to be sure that the coverage remained as desired. The standard

[1] Forty-one states have adopted the 1943 New York Standard Fire Policy. Of the forty-one states which are using the policy, all have adopted it in its entirety with the exception of Georgia, Indiana, Kansas, Nebraska, and North Dakota. In these states certain limited changes have been made to conform with statutory provisions. Under the laws of the states of Louisiana, Maryland, Missouri, and Vermont certain clauses are required to be printed on the policy. The 165 lines of the New York policy are not changed, but the clauses are printed on the policy as an addition. Maine, Massachusetts, New Hampshire, and Minnesota follow the Massachusetts form. Other than these, California, Iowa, and Texas have not adopted the 1943 New York policy.

policy eliminates this danger and provides a uniform continuity of coverage from policy to policy.

Discrepancies in the wording of policies, often considered of trifling importance by the insured, frequently gave rise to questions of coverage and consequently to difficulties in adjustment. With a standardized form such discrepancies are reduced to a minimum, with a consequent simplification of adjustment problems.

Finally, under a uniform policy there tends to grow up a body of insurance law, as reflected in court decisions, that finds ready application to questions as they present themselves. The meanings of the terms used are clarified and fixed; the conditions of the contract and the meaning of terms tend to become well understood by businessmen. The misunderstandings thus eliminated tend to reduce litigation to a minimum.

Fire Insurance Contract Personal. The policy contemplates indemnifying the owner of the property for loss actually sustained through the destruction by fire of the property insured. There is no agreement to pay a stated sum in the ordinary fire policy. The amount which appears on the face of the policy expresses the limit of liability of the company; the amount payable in any situation is to be determined by measuring the actual loss or damage. This amount is payable, however, not to anyone who may own the property damaged or destroyed, but only to the person or persons named in the policy as insureds. Property is not insured, as is sometimes stated, but the person named in the policy is insured if he shall suffer loss as the outgrowth of the perils covered. It follows, therefore, that the insurance policy is of value only to the named insured. Other interests in the property covered by the contract have no interest in the policy, or rights under it, unless their rights are specifically incorporated in the agreement.

The insured may, however, in appropriate circumstances assign his interest in the policy. The important point to emphasize in this connection lies in the fact that such an assignment, so far at least as the company is concerned, is ineffective until consented to by the company. The logic of this is readily apparent. Since the insurance company has a right to know who are its insureds, it assumes no liability to third parties under an assignment until it consents to do so.

Policies have sometimes been assigned by owners to a purchaser of a property when the sale was made. The new purchaser, unaware of the necessity of consent, accepted the policy and deemed himself the new insured. In such a situation the policy was ineffective.

In no uncertain terms the policy restates a principle long regarded as fundamental in fire insurance: that the contract undertakes within the limits set by the policy to compensate the insured for loss sustained but never goes beyond this. Regardless, then, of the face of the policy, it is the intent that the insured receive only the value of what he has lost. Even though all parties be misinformed as to the value when the insurance is placed, it is the real value, which may be determined at the time of the loss, that governs the adjustment.

The Valued Policy. Policies are sometimes written in which an agreement made in advance on the value of the property insured is required to be accepted as the basis of settlement. Valued policies have frequently been criticized as violating the principle of indemnity. States where statutes provide for or require valued policies are not regarded as following the best insurance practice. These policies are believed by many to invite carelessness and fraud and are frowned upon by insurance authorities. In the ordinary policy of insurance upon property, the valued policy may and frequently does defeat the principles of indemnity.

Where the valued policy law is considered desirable, it is provided by statute that whenever an insured building shall be totally destroyed by fire, the amount of insurance in force shall be taken as conclusive evidence of the true value of the property and the true amount of the loss or damage, regardless of the actual value of the property. Such laws, in their relation to property in general, are believed to stimulate overinsurance.

However, not only is the idea of the valued policy sound, but its use is frequently found to be desirable. It is only its misuse that may be properly criticized. Its proper use is found in insuring works of art, collections of coins and stamps, rare books and manuscripts, dies, patterns, and other items whose value is problematical or ordinarily difficult to ascertain within reasonable limits. In such a case, it is entirely in order for an insured to agree with the insurer in advance as to the value of the insured property. There is no violation of the indemnity idea. Rather, there is agreed upon in advance

the amount of indemnity that will be paid in the event of a loss. The use of such a policy in insuring a single work of art, a collection of art objects, or other unusual or unique property is not beset with any grave danger.

Demolition. It sometimes happens that insured property, within areas in a municipality restricted to specific requirements as to construction, fails to meet the requirements of the local building ordinance because of adoption of the ordinance after the building in question was constructed. Fire policies as now written do not cover the increased cost of repairs when the increase is made necessary as the outgrowth of a building code. Frequently, the ordinance makes mandatory the demolition of a building when a substantial part of it is destroyed by fire. Before the incorporation into the policy of the clause, "without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair," it was a matter of doubt whether or not a property was a total loss under the fire policy if demolition was necessary as an outcome of the fire. The New York form thus definitely settles this question, though it may be noted at this point that other standard forms are still silent on the question.

That the situation involves a real risk that is insurable can readily be recognized. To provide for the consequent loss when demolition is required by the ordinance, a clause (to be discussed in more detail later), may be added to the policy providing for the payment of a total loss. For this coverage an additional premium is charged.

Consequential Loss Not Covered. Unless the liability for consequential loss is specifically assumed under the contract, such a loss is not covered. Included in the category of consequential losses are those arising out of business interruption, such, for example, as loss of profit on goods destroyed that might otherwise have been profitably sold. A building rendered unfit for use will deprive its owner of income and its occupant of the use value of his business location. Sometimes leases are drawn with a fire clause, permitting cancellation by one or both parties in the event of a serious fire. Such a cancellation may deprive a businessman of a valuable long-term lease. The consequential damage may form an important part of any fire loss, but unless it is specifically assumed in the contract it is not covered by the policy.

Insurable Interest. It has already been pointed out that it is the element of insurable interest that takes insurance out of the wagering classification and makes it one of indemnity. Any definition of insurable interest to include within its scope all specific instances must of necessity be broad. It has been stated that every interest in property, or liability concerning it, when the nature of the interest or liability is such that the insured may suffer loss from the destruction of the property, constitutes an insurable interest sufficient to warrant valid insurance thereof. Insurance policies are written in the usual course of business by established insurance companies to cover: (*a*) loss to buildings, whether the insured has a legal title, equitable title, or beneficial ownership; (*b*) loss of income in the form of rents; (*c*) the interest of a bailee in the use of a chattel or the bailee's liability for its destruction; (*d*) the interest of a person having a specific lien; (*e*) the interest of a partner in partnership property; (*f*) the interest of a contractor in a building under construction where payment is withheld or the right of payment arises on completion; (*g*) the liability of a carrier to an owner; (*h*) freight payments due a carrier depending upon a delivery of a shipment; (*i*) the interest of a leaseholder in the event his lease is terminated by fire; (*j*) undivided part interest in real estate owned outright or for life only; (*k*) fractional or divided interests; (*l*) improvements on leased property made by tenants; (*m*) the reversionary interest of a beneficiary where an estate has been entailed; (*n*) the interest of a mortgagee; (*o*) the interest of a vendor or vendee in possession; (*p*) the interest of a stockholder in corporate property in which the holdings are large enough to represent an insurable interest. Where the element of insurable interest ends is not easily determined.

A mere expectancy without a legal basis is not insurable. A creditor, therefore, has no insurable interest in the property of his debtor unless he has by some legal means acquired a specific lien. Neither has a legatee or a devisee an interest in an estate prior to the death of the testator. To constitute insurable interest there must be present the element of financial loss. If the interest in a property is limited to a hope or expectancy, there is no insurable interest.

Finally, it may be pointed out that there may be several insurable interests in the same property. Too, while the insurance contract is one of indemnity, it is possible to visualize a situation in which the sum of the insurable interests exceeds the total value of the property.

This situation is not usual. Again, although the various interests noted are insurable, the interest should be definitely stated.

Inception and Termination. A contract of insurance need not be in writing. Every day there are literally thousands of insurance contracts made without so much as a scratch of a pen. A policy is ordered by the insured, and the insurance agent agrees that it shall become immediately effective or effective at a designated time. When insurance coverage of this sort is effected, it is ordinarily for a short period, pending the drawing up and delivery of the formal contract or policy. Insurance in such an instance is said to be "bound." In every insurance agency a record of some sort is provided in which bound risks are entered. No particular form is required, and ordinarily a blank record book suffices. Upon receiving an order for insurance, the agent will enter in his book, which is known as a "binder," the date and hour. He will then enter the name of the insured, the date and hour the insurance is to become effective, the property to be covered, all pertinent information and conditions to be incorporated in the policy, and the amount of insurance. He will then apportion the insurance among the companies he intends to commit to the risk, with the amount at risk for each company indicated. From the moment the companies are committed, their liability begins, unless a future time is indicated. Where written evidence of the binder is required, forms are provided for the purpose and upon request will be forwarded properly completed to the insured, pending delivery of the policy.

When a policy is issued following a binder, it is the custom to date the policy back to the inception date indicated in the original binder. This procedure is by no means necessary, and a binder may be carried for a certain time and paid for separately, to be followed by the issuance of the policy at a new and later date. Under the standard policy, the insurance becomes effective on a given day at noon and is written for a term to expire likewise at noon on a specified day.[2]

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[2] When no particular time has been designated, there has been considerable uncertainty as to whether standard time or local sun time was contemplated. Courts have been inclined to an interpretation favorable to the insured, as in an instance when a fire broke out at 12:02 P.M., standard time, which was 11:45 A.M., sun time. It not being shown that the parties had intended standard time, it was held that the insurance had not expired at the time of the fire, and that the company was therefore liable. In the New York standard form this uncertainty has been eliminated by the inclusion of the condition: "The word *noon*, herein stated, means noon of standard time at the place of loss or damage."

Liability under the policy continues for loss after the time of expiration of the policy, when the cause originated before that time. It is held that, if a fire causing damage breaks out before the policy expires, the company is liable for all the damage that comes within the limits of the coverage, even though most of the damage was occasioned by a continuance of the fire after the time for the policy to expire.

When the day and time indicated in the policy arrive, and there is no happening of the contingency insured against, the coverage automatically terminates. Under a fire policy, a loss cancels the contract if it is large enough to exhaust the payment of the face of the policy. If, however, the loss is less than the amount of the insurance, the policy is reduced in an amount equal to its contribution to the loss. This point is important to remember, for with the policy remaining in the possession of the insured, he may forget that his coverage is lessened and restore the damage without having the insurance restored. It is the custom, for a pro rata additional premium, to have the agent of the company restore the policy by endorsement when a loss has been replaced, rather than to issue a new policy. This enables the insured to keep his policy record and expiration dates unchanged. He may, of course, if he wishes, cancel the unexpended portion of his policy and have a new one written, dating from the loss.

The insured may at any time have the policy cancelled, and no notice by him is required. He is obligated on demand to surrender the policy and is penalized as to premium. The premium to be returned by the company represents the balance after charging for the expired term on the short-rate basis. If the policy has been cancelled for a convenience and is being renewed in the same company for the same or a greater amount, it is the custom of the companies to charge the earned premium on the pro rata rather than the short-rate basis.

When cancellation is ordered by the company, five days' notice must be given every named insured or interest. In the case of a mortgagee, the policy provides: "If loss hereunder is made payable, in whole or in part, to a designated mortgagee not named herein as the insured, such interest in this policy may be cancelled by giving to such mortgagee a ten days' written notice of cancellation." It is to be noted, therefore, that while named insureds are to receive five days' notice, the mortgagee receives ten. When the demand for cancellation originates with the company, pro rata premium only may be

charged for the period which the policy has run, and not short rates, as in the case when the insured makes the demand.[8]

The New York standard form does not require the return of the unearned premium as a condition precedent to cancellation. When this was required, the procedure for effecting a cancellation became almost ritual. It was required that the agent of the insurer, personally and in the presence of witnesses, hand a notice together with the unearned premium in legal tender to the insured, reading the notice to the insured if possible, or in any case stating its purpose. Extreme care was to be exercised that legal tender only be utilized, that the very least number of subsidiary coins necessary be used, and that paper money be avoided unless the agent was sure that it was legal tender. If notice and money were refused, the company representative was to leave both in a convenient place. The New York standard form makes cancellation effective upon proper notice, without tender of the unearned premium, provided notice is given the insured that he is entitled to a return premium that will be paid him upon request.

Personal Property. Personal property of nearly every sort may be insured. Under the New York standard policy certain types of property are excepted from the coverage of a policy which is written with the description in general terms, while other types are uninsurable in any case. In the terms of a policy which reads, "This policy shall not cover accounts, bills, currency, deeds, evidences of debt,

[8] To cancel a policy effectively, the company must notify the premium-payer, all parties named as insureds, and all parties named as mortgagees. The notice must state unconditionally the company's determination to cancel at a specific time. Notice of cancellation does not become effective until actually received. Therefore, the time will not run on the notice until actually in the insured's hands. Nor is the time computed from the instant of receipt. The first day, that is, the day the notice is received, is excluded in the computation of the time, and, beginning with the next midnight, the days are counted, running from midnight to midnight.

When it is not convenient to reach the insured and serve the notice personally, the company sends a notice by registered mail. Elaborate forms have been prepared for the purpose. Some are so printed as to become, when folded, envelopes, thereby avoiding the possibility of the insured's claiming to have received an empty envelope. Sometimes these notices are made in duplicate, and the postmaster is asked to witness the inclusion of the notice in the envelope. Finally, a demand is made for a personal return receipt. The letter containing the notice should bear, plainly marked or printed, the name of the agent or company sending the notice, because a failure to do so has been deemed grounds for claiming no notice, when an insured received the envelope containing it but carelessly laid it aside unopened. It was held that had he seen the agent's or company's name, he might have been warned that the communication pertained to insurance and given it attention. An insured, of course, may waive the requirements as to notice and surrender his policy for immediate cancellation.

money, or securities; nor, unless specifically named hereon in writing, bullion or manuscripts," it is to be seen that if bullion or manuscripts are to be included in the coverage they must be specifically mentioned. Under the old New York form this list is somewhat longer, and it varies in the standard forms of other states. It is to be noted that in the case of accounts, bills, currency, deeds, evidences of debt, money, notes, or securities the policy plainly states that they shall not be covered. In other words, under the standard fire policy form they are not in any event insurable.

With the exception of the articles just noted, personal property in which an insurable interest exists may be covered by the fire policy. Of course, unconditional ownership represents an insurable interest. Part owners or joint owners may likewise cover their respective interests. Property held in trust, or on commission or consignment, or on joint account, or sold but not removed, are all insurable. In fact, wherever there is an existing liability to others for property held there is an insurable interest.

If labor has been expended on property belonging to others, until payment has been received an insurable interest in the property exists. Profits or commissions on property that would have been available but for a fire are properly insurable, as is the liability of warehousemen, pawnbrokers, common carriers, and the like.

Interest at Time of Loss Sufficient. Compliance with the requirements of an insurable interest originally required that the interest in the property exist both at the time the policy was issued and at the time of the loss. The doctrine has now been modified to recognize as valid a policy issued upon property where no insurable interest existed at the time the policy was issued, but which was later acquired and was retained at the time the loss occurred. It is this extension of the doctrine that validates a policy upon a stock of goods that is being increased or changed from time to time.

Warranty as to Ownership. There is no warranty as to ownership in the New York standard policy of 1943. The insuring clause limits the amount that may be recovered to the "interest of the insured." Hence, if the insured is something less than sole and unconditional owner, he may not collect in the case of loss to the property for the full amount of the damage unless his interest in the property is such that the amount of the damage will represent actual loss to him. It is the intent of the policy to provide indemnity for loss sustained.

This was not accomplished in some of the older policies that voided the contract under the so-called "moral hazard" conditions.[4]

Executors, trustees, and heirs have frequently been concerned with the validity of the insurance, covering the property of the deceased, in effect before his death. Formerly, the passing of property by death was considered to have voided the insurance in effect in the name of the deceased. It can readily be seen that a grave element of danger would exist in such a situation, however, and to make the coverage continuous a policy today remains effective for his legal representatives in the event of the insured's death.

Subrogation. The New York standard policy definitely incorporates the doctrine of subrogation into the policy with this clause: "This Company may require from the insured an assignment of all right of recovery against any party for loss to the extent that payment therefor is made by this Company." Though the right of subrogation exists without being expressly incorporated into a contract, it is held, however, that by thus incorporating the conditions into the contract the insurer is protected from having this right destroyed by action of the insured.

To this end it is essential that an insured be extremely careful that in making contracts he waive no rights of recovery in event of loss. There is grave danger that such a waiver by an insured might so change the nature of the risk as to void the policy. In connection with contracts with railroads for sidetracks, corporations making deliveries of explosives or inflammable materials, or anything else by which claims for damages are waived, it is the proper procedure to have the fact of the waiver acknowledged by the fire insurance company and its consent thereto endorsed upon the policies.

Anti-waiver Clause. The doctrines of waiver and estoppel are not peculiar to the business of insurance, but here the doctrines have found frequent application; and, because of the frequency with which they have been brought forward to give life to a policy apparently

[4] For example, the New York standard policy of 1918 states: "This entire policy shall be void, unless otherwise provided by agreement in writing added hereto, (*a*) if the interest of the insured be other than unconditional and sole ownership; or (*b*) if the subject of insurance be a building on ground not owned by the insured in fee simple; or (*c*) if, with the knowledge of the insured, foreclosure proceedings be commenced or notice given of sale of any property insured hereunder by reason of any mortgage or trust deed; or (*d*) if any change, other than by the death of an insured, take place in the interest, title or possession of the subject of insurance (except change of occupants without increase of hazards); or (*e*) if this policy be assigned before a loss."

void in the light of facts taken in connection with the written document, the framers of the standard policy have undertaken to require waivers to be in writing to be effective. To this end the anti-waiver clause is incorporated in the standard policy. Familiar with the difficulties and with what seemed to be abuses arising from parole waivers, the makers of this clause intended that a waiver to be effective should be in writing. In this they were not entirely successful. The courts have held that just as other provisions of the policy may be waived, so may the one that requires waivers to be in writing. It is held that this clause, indicating the form and manner of making waivers, may itself be waived by anyone with authority to do so. Thus, in spite of the anti-waiver provision previously cited, parole waivers may still be evoked to contradict or modify the written terms of the policy.

Fire Defined. The standard fire policy provides insurance first of all "against all DIRECT LOSS BY FIRE." The phenomenon of fire is familiar to everyone, yet for the purposes of determining the existence of loss it frequently becomes necessary to know the limitations within which a fire may be said to exist. Fire is produced by combustion, yet all combustion is not a fire as contemplated by the fire insurance contract. The presence of heat, steam, or even smoke is evidence of fire, but taken by itself will not prove the existence of fire. Heat sufficient to cause charring or scorching, unless accompanied by ignition, does not constitute fire. To constitute fire, combustion must proceed at a rate sufficiently fast to produce a flame, a glow, or incandescence. Regardless of the amount of heat, there can be no fire until ignition takes place.

To serve as a basis for doubtful cases, the definition laid down by the United States Circuit Court of Appeals in the case of *Western Woolen Mills Company* v. *Northern Assurance Co.* (139 Fed. 637) is frequently cited. The case concerned spontaneous combustion in wet wool. Defining "fire," the court said:

> Spontaneous combustion is usually a rapid oxidation. Fire is oxidation which is so rapid as to either produce flame or a glow. Fire is always caused by combustion, but combustion does not always cause fire. The word "spontaneous" refers to the origin of the combustion. It means the internal development of heat without the action of an external agent. Combustion or spontaneous combustion may be so rapid as to produce fire, but until it does so, combustion cannot be said to be fire.

Lightning. Under the provisions of the older standard policies.

damage from lightning is not covered unless fire ensues, and in that case the coverage extends only to the damage caused by the fire. In other words, if lightning succeeded in wrecking a building, and the wreckage were then to catch fire, the fire insurance policy would cover the loss of the wreckage but not the lightning damage.

Lightning is frequently the cause of serious loss, though there is neither indication of fire or, for that matter, evidence of the presence of heat. When the policy was endorsed to include damage from lightning, "whether fire ensues or not," such losses fell within the limits of the coverage afforded by the policy. The difficulty of determining at what point the lightning damage ended and the fire loss began was eliminated. It has been the general practice so to endorse policies. The 1943 New York standard policy, however, obviates the necessity for such endorsement by specifically including loss by lightning as well as by fire in the insuring clause of the policy.

Friendly and Unfriendly Fires. The insurance contract contemplates the provision of indemnity for loss arising from the happening of an unfavorable contingency. The element of accident in the cause is essential. Hence, a fire deliberately kindled and remaining within the limits intended for it is termed a "friendly fire," and any damage that it may do is not covered by the fire policy. However, when a friendly fire spreads beyond the confines intended for it and beyond the control of its custodian, it ceases then to be a friendly fire, and the damage it causes is a loss under the fire policy.

The flame of a lighted lamp or gas jet or the fire in a stove, a fireplace, an oil burner, or a furnace is in each instance regarded as a friendly fire. Damage from such fires, in the form of smoke, soot, or heat, is not a damage covered by the fire policy. Thus, a lamp or oilstove left burning in a room during the absence of any attendant may creep up and smoke, send a filthy, black, oily soot throughout the premises and do hundreds of dollars' worth of damage. The loss is not covered by the fire policy. On the other hand, if the fire escapes from the confines in which it is intended that it remain, the fire becomes unfriendly, and whatever damage is thus done, the fire policy covers. Consequently, if a breeze blows a curtain against the flame of a lighted lamp, and the curtain burns, the property thus destroyed is covered.

Direct Loss and Damage. The insurance contract specifies that a loss to be covered under the policy must be a direct loss. This has

been construed by the courts to mean that fire must be the immediate or proximate cause of the loss, as distinguished from the remote cause. In a train of circumstances culminating in a result, the proximate cause is held to be the efficient cause, that is, the one that sets intervening agencies in motion. Thus, the courts have held that causes that are merely incidental to a superior or controlling agency are not proximate causes, even though they be nearer in time to the result. Hence, a fire may be the direct cause of a loss or damage, even though some intervening agency may form part of the chain of circumstances set in motion by the fire. For example, it was held that a fire in the tower of a building, where it was confined with but slight damage, was the proximate cause of a large machinery loss in a part of the building remote from the fire. The fire in the tower burned electric wires that caused a short circuit. This in turn set in motion a train of circumstances causing a general breakdown of the machinery. The entire loss was held to be by fire. In the case of a steamboat which caught fire and sank following a collision before the goods on board, that had been insured against loss by fire, had burned, it was maintained that the boat might have been saved after the collision but for the intervention of the fire. Because, however, the fire prevented the use of the available means and appliances for saving the boat, fire was the proximate and immediate cause of the loss.

There are numerous examples of cases in which fire has been held to be the direct cause of the damage growing out of the collapse of walls, which formed a part of ruins. When a building was destroyed by fire, and part of the ruined walls fell two days later, damaging a neighboring property, the insurance company covering the second property was held liable for a fire loss. In another instance, the wind blowing a gale caused the high wall of a burned building to topple and damage adjoining property seven days after the fire. It was ruled that fire was the proximate cause of the damage to the property injured by the toppling wall and that the damage, therefore, was covered by the fire policy. In a case in Alabama, which is considered extreme, the court held the insurance company liable on the fire policy when the damage from the falling wall occurred during a high windstorm four months after the fire. On the other hand, if a fire engine on the way to a fire accidentally strikes and damages insured property, the fire is not held to be the controlling agency in this case, and the fire insurers are not responsible for the loss. The cause of

the accident and the cause of the fire are held to be independent, one of the other, and damage to the property by the fire truck is attributable to the accident or its cause, and not to the fire. Loss or damage caused by smoke, heat, water, or other materials used to extinguish the fire, damage caused by the fire fighters, and unavoidable exposure at or following the fire, are direct losses covered by the policy.

It may be stated, in the way of summary, that when an unfriendly fire sets in motion a chain of circumstances that result in the destruction of the subject of the insurance, the loss is covered by the fire insurance policy. When, however, there is more than one cause, and these causes are independent of one another, the courts have held that the nearest is the one to be charged with the disaster.

Loss by Removal. The loss incurred by removing property endangered by fire has been definitely assumed under the terms of the New York standard policy. While the insured is obligated to do everything reasonable to save threatened property, and such costs are not insurance losses, it is now held, regardless of the statement in the policy, that when damage is sustained in the operation of removal the fire is the direct and proximate cause, and the insurer therefore is liable.

It may be pointed out that the removal must be deemed reasonably necessary in order to charge the insurance carrier, and the threatened danger must be of a nature that would prompt a careful and prudent uninsured person to take a like action in his own interest. Losses caused by breakage and exposure, when there is no element of gross negligence, as well as cost of removal, are cause for proper claims. Losses by theft are specifically excluded from the coverage.

The insurance follows the property to whatever point it is removed and continues in effect in the new location, covering pro rata on the old location, and on each location to which the goods may be removed, for a period of five days after the fire. When the five-day period has elapsed, the insured must make provision for new or continued coverage in the new locations, or he will be without insurance.

Actual Value. The policy undertakes to indemnify the insured "to the extent of the actual cash value of the property at the time of loss. . . . ." It was the intent of the framers of the standard policy to incorporate in the policy by means of this clause the idea of indemnity already considered. Regardless of the amount written into the policy, the amount collectible is limited to the actual cash value of the prop-

erty insured. The exception, of course, is in the case of the valued policy.[5]

Cost of Repair or Replacement. Time and other factors frequently become an element in the question of valuation. The policy provides that its liability shall be limited by the actual cash value at the time of the loss and adds the additional restriction: "but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time after such loss, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair. . . . ." Thus, when the value exceeds the cost of repairing or replacing, a limitation is placed upon the amount recoverable. For example, during World War I, when the demand for shipping was at its peak, a ship might be sold for several times its replacement cost, the time element contributing to its value. This type of value the fire insurance contract does not undertake to cover.

The insurance contract does not undertake to supply "new for old." Depreciation, as used in connection with fire insurance, includes as well the element of economic obsolescence. Thus, a property whose value is lessened by age and use, changing business conditions, neighborhood changes, and the like, is subject to depreciation when its value is computed for the purpose of loss adjustments.[6]

Assignment. It frequently happens that, with the sale of an in-

[5] The so-called "replacement coverage" is sometimes written to insure buildings, equipment, machinery, and contents other than household furniture in dwellings for the difference between the actual value at the time of the loss and the cost of repairing, rebuilding, or replacing if the property is totally destroyed. Under the policy terms, replacement coverage is payable only if the property is rebuilt.

[6] By limiting the loss to the cost of replacement, there is sometimes an element of confusion in the case of manufactured goods. It is the intent of the policy to indemnify the owner of the destroyed property, but not to include in the figure any element of profit. If the manufacturer can make the goods in his own plant, his manufacturing costs represent the figure of the loss. It sometimes happens that a manufacturer cannot exactly reproduce the destroyed goods. There is on record a case in which particular grades of whiskey were destroyed, each of different ages and of a known market value. When the claim for insurance was presented, the company contended that its liability was limited by what it would cost the insured for material, plus the expense of manufacturing the whiskey, the expense of carrying it in bond, the cost of insurance, and the interest on the amount invested. The court ruled, however, that because of the element of age, the cost of whiskey of like quality and age was the measure of the insured's right of recovery, and this cost was to be ascertained by the cost of replacement at the date it was destroyed, "considering the brand, character, quality and age of the whiskey." In this case, because of the special characteristics attaching to the goods, the processing costs could not serve as a limit because the goods could not be reproduced within a reasonable time.

sured property, it is desired to transfer the insurance to the new owner. An assignment of an insurance policy without the consent of the company thereto is ineffective. It is, therefore, of the utmost importance, when such a transaction is contemplated, that the policy be endorsed with the company's consent, as well as the insured's assignment of interest. Ordinarily, an assignment carries with it only such rights as are possessed by the assignor. In the case of a fire insurance policy the transfer is not, in the strict sense of the word, an assignment, but rather a novation. A novation is a new contract, in this case between the insurer and the assignee. The relationship between the two original parties is terminated, and a new contractual relationship established.

To accomplish the same end, another and more common method is followed. The policy without assignment is delivered to the office of the company or its agent, with the request that the insured under the policy be changed, and the coverage transferred from the insured named in the policy to the newly designated insured. This is accomplished by means of an endorsement, drawn by the agent and signed by him, stating that the interest of the named insured has on that date terminated, and that it is understood and agreed that from that date on the insurance shall continue in effect for the benefit of the newly designated insured.

Concealment or Fraud. Entirely aside from the breach of any warranty that might void the policy, it is specifically provided with reference to concealment or fraud: "This entire policy shall be void if, whether before or after a loss, the insured has wilfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto."

Fraud most frequently makes its appearance in connection with the adjustment of claims. Incorrect loss statements are prepared, salvage concealed, books falsified, false testimony given under oath, and false proofs executed and sworn to. It has sometimes been offered as a defense that the false statement made in connection with the claim was for some purpose other than to defraud the insurers, as when a claimant contended that his statements were made to substantiate statements previously made to a credit company. The courts have held, however, that a false statement on oath concerning

the subject matter vitiates the policy, whether or not the purpose was to deceive the company.

Fraudulent acts of an insured's agent, even though perpetrated in an effort to further the interests of his principal, and even though they are committed while the agent is representing his principal in adjusting the loss, will not have the effect of voiding the policy, so long as the insured has no knowledge of the fraudulent act or in any way has consented or acquiesced thereto.

Suspension. A number of conditions in the policy have as their effect the prohibition of certain situations. These are for the most part concerned with increasing the hazard. The clauses in this group, however, do not have the effect of voiding the policy absolutely, but rather act to suspend or restrict the insurance coverage.[7]

When the risk is written and the rate fixed, it is assumed that the risk will remain constant during the life of the policy. If there is any change, the insurer should have the opportunity either of canceling the policy or of securing a higher premium.

It might be contended that the one clause suspending the coverage if the hazard was increased would be comprehensive enough to include the others within its scope. Since in every case what does constitute an increase in the hazard is a matter of fact, and hence in litigated cases a matter for the jury to decide, the framers of the standard policy undertook, in addition to including the more comprehensive clause, definitely to incorporate special situations which in their opinion increased the risk to a degree that warranted a suspension of the coverage.

As the result of riot and explosion, the policy is not suspended, but loss is restricted to damage by fire only. This has been the general rule in the case of explosion, but, until the 1943 New York policy, loss caused directly or indirectly by riot, was not covered. This created a serious gap in the fire coverage and as well left an important source of doubt in instances where it was not altogether clearly established whether or not the fire could be attributed to a riot. The policy does not cover sabotage, vandalism, and other like damage that might

[7] In the policy it is stated: "Unless otherwise provided by agreement in writing added hereto this company shall not be liable for loss or damage occurring (*a*) while the hazard is increased by any means within the control or knowledge of the insured; or (*b*) while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of sixty consecutive days; or (*c*) as a result of explosion or riot, unless fire ensue, and in that event for loss by fire only."

originate from a riot but does include within its scope losses caused by fire.

In the case of both riot and explosion, if there is loss prior to the inception of the fire, the liability of the fire insurance company extends only to the value of the property at the time the fire started. In other words, if a property is partly demolished by explosion and a fire follows, the fire policy is not responsible for the wreckage caused by the explosion, but only for the loss caused by the fire to the property in its wrecked condition. The rule is similar in the case of riot. If the property is sabotaged, and the fire follows, the fire policy picks up on the property in its condition at the inception of the fire.

FOR REVIEW

1. X is purchasing a piece of property for B, but during the transaction legal title is in the name of X, and there is no indication of the equitable ownership of B. A fire occurs while title rests in X. The insurance is carried in the name of X. Can he collect under the policy?
2. The dwelling house of X is insured for $8,000. After a total loss, evidence is introduced to show that it was assessed for $4,000. Can the assessed value be used as a measure of damages?
3. The household furniture of X is totally destroyed. A list of the items is presented to the insurance company showing a valuation of $1,000. The insurance company is able to prove conclusively that the insured offered the furniture for sale for $300. Can the company set this as a measure of value?
4. The roof of a building is totally destroyed. X claims that the insurance company should replace it with a new roof. The insurance company claims the roof to be ten years old and wishes to deduct depreciation. Is this permissible?
5. X built a fire in his stove, and the pipe became overheated. In an effort to save the property from a total loss by fire, X throws water on the overheated pipe. Will the fire insurance policy be liable for the loss or damage to the ceiling?
6. A fire destroys the dwelling of X. He is able to prove that a $500 diamond ring, a $1,000 bond, and $50 in money were destroyed. Is the loss covered by the fire policy?
7. A truck traveling along the main highway rolls off the road, collides with a set of farm buildings, bursts into flame. The fire spreads to the farm buildings to the end that they are totally destroyed. Outline the insurance implications.
8. Acid is thrown on some frescoes painted on the walls of a public building by malicious persons with the intent to destroy them. It is claimed that the acid reaction is combustion, and hence a fire. What is your opinion?
9. A roast cooking in the oven overheats, becomes badly burned, and as a

result smoke permeates the house, damaging both the dwelling and furniture. Is the smoke loss covered under the standard fire policy?

10. The stock of goods of a wholesale grocer is destroyed. One item of molasses had a value the day of the fire quoted in New York of $3,000. The insured is satisfied with this figure but claims there should be added to it the cost of transporting the molasses from New York to his place of business. Is his contention correct?
11. X, while under the influence of liquor, negligently throws a lighted match from a cigarette into a pile of shavings and starts a fire that destroys his woodworking plant. Are the fire insurance companies liable for the loss and damage?
12. M, the wife of B, infuriated by some act of her husband, sets fire to his house. Are the insurance companies liable?
13. A and B own camps located beyond fire protection in a summer colony; A's camp is fully insured, and B carries no insurance. A, while setting off fireworks during a Fourth of July celebration, sets fire to his camp, and it is totally destroyed. The fire then spreads and destroys B's camp. B claims A to be negligent and undertakes to hold him responsible for the damage to his camp. What is your opinion of B's position?
14. A fire engine on the way to a fire collides with an automobile and demolishes it. The owner of the automobile claims his loss to be directly caused by fire. Are his fire insurers liable?
15. The accumulated soot in a chimney catches fire, and as a result considerable smoke damage follows to the contents of the building. There is no fire outside of the heating plant or chimney. Are the fire insurance companies liable for the loss and damage?
16. X shipped a carload of lumber on a river steamboat. The cargo was insured against fire. As a result of a collision, the steamer caught fire and sank. The goods of X were lost before the fire had spread to reach them. Is this a fire loss?
17. X owns a brick building insured against loss by fire for 100 per cent of its value. As a result of a fire it is completely gutted, but the four walls are standing. X claims the loss to be total. Is this so?
18. The building of X was destroyed by fire on February 15, though the walls were left standing. On February 20, all of the walls collapsed and damaged a neighboring structure. The neighbor claims this to be a fire loss. In your opinion, are the fire companies liable and, if so, should the company insuring the building that burned pay the losses, or the company insuring the building damaged by the falling wall?
19. Assume an annual premium of $100 and an interest rate of 4 per cent; is it more economical for a purchaser of a fire insurance policy to buy a term policy for three years or for five years?
20. A plumber thawing a frozen roof drain brings his blowtorch by accident in contact with a sprinkler head. The sprinkler head opens and causes $1,000 water damage. Do the fire insurance policies cover?
21. A new trunk highway is being surveyed through the state of Maine. It passes

through the farm buildings of X. The state has condemned the land upon which the buildings are located, but it has given the owner until a certain date to move the buildings. After that date the original owner loses all title, and the buildings are without value. Can X insure the buildings in the meantime?

22. X and Y, two brothers, inherit a house from their father. X is married and living in the house, and Y has moved from the community and feels that he has actually given his interest in the property to his brother. The property is destroyed by fire, and X undertakes to rebuild. He pays for the new house entirely out of his own funds and now wishes to insure it. Explain his position.
23. May a company cancel a policy after a loss has occurred and before the loss has been paid?
24. In dealing with a local agent, who represents a number of companies, the insured rarely specifies the particular company or companies that are to carry his line. He leaves that to the discretion of the agent. It may happen that a company given a line is already committed to its limit in that locality and asks the agent to cancel. If the agent writes a new policy in another company with a view to taking up the outstanding policy, and a fire occurs before the exchange can be made, what is the position of the insured?
25. Is it necessary that an insured have an insurable interest in a property, both at the time the policy is issued, and at the time of the loss?
26. What is the position of an insured who loses his fire insurance policy?

CHAPTER XIV

STANDARD POLICY MODIFICATION

RIDERS Modify Standard Policy. It was the aim of the framers of the standard policy adopted by the various states to draw up an insurance agreement that would treat fairly both the insured and the company, and one that would be comprehensive enough in its scope to satisfy every situation. Since it was designed for use in connection with all classes of property, and since its use has extended to insuring nearly every known insurable interest, it can readily be seen that it would be impossible to devise a complete contract that would meet all needs. The policy is also designed to cover hazards other than fire and refers, in the insurance clause, in addition to fire, lightning, and removals, to "THE PERILS INSURED AGAINST IN THIS POLICY." To make provision for the inclusion of further perils the policy provides: "Any other peril to be insured against or subject of insurance to be covered in this policy shall be by endorsement in writing hereon or added hereto." Insurance underwriters have found, as the outgrowth of experience, that with the extension of the fire coverage to include other perils it is sometimes necessary to further clarify the extent of the coverage. The framers of the policy recognizing that such situations would develop have made provision, therefore, by incorporating the following clause in the standard contract:

> The extent of the application of insurance under this policy and of the contribution to be made by this Company in case of loss, and any other provision or agreement not inconsistent with the provisions of this policy, may be provided for in writing added hereto, but no provision may be waived except such as by the terms of this policy is subject to change.

The policy is arranged with a blank page for the attachment of endorsements. In this space is attached, first of all, a rider known as a "form." This rider contains a description of the property to be insured and includes, as well, a number of clauses pertinent to the particular contract and the risk to be insured. Clauses may also be added extending the coverage to include such hazards as windstorm, explosion, damage from falling aircraft, and other like extensions presently to be noticed.

Insureds who have familiarized themselves with the conditions of standard forms and policies are sometimes inclined to confuse the modifications permitted in the form with the terms and conditions of the policy. This gives rise to the opinion that the standard policy affords coverages that, as a matter of fact, it does not afford. It is of the utmost importance to recognize that certain coverages and privileges, as well as certain restrictions and conditions, originate in the form attached to the policy as a rider, and not in the policy itself. It will be readily seen, therefore, that it is highly essential for an insured, whose plan of insurance requires a number of policies on the same property, to have his policies carefully checked and to see that the forms are identical.

Description and Location of the Property. The first essential in the preparation of the form is an adequate description of the subject matter of the insurance. Length and excessive verbiage are not indicative of the most desirable form of description; nor are vague and general terms. The description should be short and concise, clear-cut, accurate, and inclusive enough to describe adequately the property intended to be covered. Obviously, the task is not a simple one, and much care and thought have been exercised in the preparation of the forms in general use.

The description of the building, so far as the needs of the insured are concerned, should be sufficiently accurate to indicate exactly the property the insured wishes to cover. Confusion sometimes results when there is doubt as to whether extensions and additions are included, particularly if their construction varies from the description of the main building. If more than one building on the same lot is covered, this should be clearly stated. If sheds or other incidental buildings are part of a property, the description should clearly indicate the extent and nature of the coverage intended.

The method of describing buildings is to a considerable degree standardized by rating classifications. Reference is usually made to height, roof, construction, and occupancy. Contents are described in as comprehensive a manner as possible, the description being followed with the statement, "while contained in," which is followed in turn by the construction, type, and location of the building.

The location of the property is a matter of little difficulty in the built-up sections of the city. Usually the street address, with an indication of the side of the street, is sufficient—thus: "located at No. 130,

on the westerly side of Cedar Street, Bangor, Maine." Where buildings are not numbered, any indication that is clear and will serve to indicate location is sufficient—thus: "Located on the northerly side of the River Road, about three hundred yards in an easterly direction from Grange Hall, in the Town of ———, etc." Indicating a side of a given road, particularly if a long one, without tying in with some permanent landmark, is considered undesirable. A railroad crossing, a standpipe, a crossroad, a local store, or a public building, such as a hall or church—anything that is distinctive—will indicate within sufficiently narrow limits the location of the property insured.

Permanent Fixtures. In connection with the description of the property to be insured, it is of importance to understand that permanent fixtures may be insured with the building. The significance of this information to the insured lies in the fact that, the building rate ordinarily being less than the contents rate, a saving in premium is effected when the building form is extended to cover permanent fixtures. Machinery having to do with the service of the building, such as fans, ventilator systems, and the like, as well as the heating plant, may be thus included, as may refrigerating apparatus and equipment in cold storage plants. In school buildings, seats may be included in the coverage as part of the building, as may pews, altars, confessionals, shrines, pulpits, and the like in church buildings. In apartment buildings, stoves, refrigerators, floor coverings, cleaning apparatus and other equipment used by the janitor, as well as fuel, heating plant, and other property of the owner designed for permanent use in the building, may be included in the building form.

Removal. When goods are to be transferred from one location to another, it frequently happens that the entire property covered by the policy cannot be moved as a unit, but some parts remain in one location while others are removed to the new location. This situation can be covered by attaching a removal permit to the policies. The permit extends the insurance to the new location and at the same time continues coverage on the old on a pro rata basis; and when removal is completed, the coverage becomes entirely effective at the new location. A readjustment of the premium is made on the basis of the rate at the new location, with an additional premium charge if the rate is higher, and a refund in the form of a return premium if the rate is lower. The permit does not cover perils of transporta-

tion, and if protection on the risk is desired, a transportation coverage on an inland marine form becomes necessary.

Indicating the Insured. When the insured is an individual, his name in full, or as he is ordinarily known, should appear in the policy. If he carries the insurance in some capacity other than sole owner, such as administrator, executor, trustee, or the like, this relationship should be indicated. It sometimes happens that more than one interest is to be covered, such as that of owner and contractor, owner and lienor, or that of an undivided ownership. The names of the interested parties may, in this instance, be inserted in the form and policy, to be followed by the phrase, "as interest may appear." Thus, when the interest is a changing one, as in the case of a contractor constructing a building and from time to time receiving payments, the policy covers these interests as they are shown at the time of the fire.

Uncertain or vague descriptions are frowned upon, and may be a source of considerable confusion and annoyance. Thus, a policy written for the heirs or the estate of a deceased individual, without specifically naming them, may cause difficulty in the case of an adjustment. From the standpoint of adjustment, the procedure is simpler if the policy names definite persons as insureds rather than a group whose membership must be determined in order to learn with whom to negotiate in order to effect a settlement. The possibility of omitting an interested party is always a matter of grave concern. The proper procedure in the case of an estate is to name the heirs as insureds, and if there are minors, to name their legal representative and them as well. Thus we would have "John Doe, guardian of Richard Doe, infant." If, however, it is impracticable to insert the names of all the insureds, and even in cases in which all the names are inserted if there are a number of heirs, it is the part of wisdom to indicate a representative with whom adjustments are to be made. The following form has been recommended: "Loss, if any, to be adjusted with, payable to and recoverable by John Doe, and by him only."

Vague and uncertain expressions, as "for whom it may concern," are considered to be undesirable, since the end sought by the insurer can usually be effected in some other and more satisfactory manner. The clause is sometimes used by the owner of a warehouse or storage

plant to cover the contents stored there, regardless of who the owner may be. When this form is used, owners of goods for whom the coverage is contemplated may ratify the insurance after a loss and proceed to collect under the policy as if they were specifically indicated as insureds. If policies are so written, confusion and uncertainty will be eliminated if the purchaser of the insurance will have himself named as the one with whom adjustments are to be made and to whom losses are to be paid, using the form indicated for estates.

Another clause that has been the source of considerable difficulty and annoyance is the so-called "commission clause." Inserted in the form, the clause reads in the following or similar terms: "His own or held by him in trust, or on commission or consignment, or on storage or for repairs, or sold but not removed, and for which he may be liable." When first used, the clause was in all probability intended to cover the named insured and to bring within the scope of the coverage, goods not actually owned by him, but for which he was legally liable, and for which he would have to pay in the event of their destruction. It sometimes happens that this form serves best the purpose of the insured, as for example, the owner of the warehouse, who is also a dealer in the commodities handled, and whose title frequently changes by bookkeeping entries.

If the clause is used, the purchaser of the insurance should be certain that the amont of insurance is sufficient to provide adequate coverage, not only for his own property, but also for any property on the premises that might be brought under his policy by means of the clause. He should also incorporate a clause excluding property upon which there is specific insurance. This can be done by inserting the phrase: "This policy does not cover property specifically insured." Finally, the purchaser of the insurance should name himself as the one with whom the adjustment of losses is to be made and to whom they are to be paid. The danger of the commission clause is to be found in its unnecessary inclusion in policy forms. It is now held that, regardless of whether or not a bailee has assumed liability for property on his premises, or whether or not he is legally liable, if the commission clause is found in his policies, the owners of such property may, upon learning of the fire and the form of policy, at once ratify the insurance and proceed to collect under it as if they were named insureds. An insured who has contemplated covering, in addition to his own property, only that for which he has assumed liability or

for which he is legally liable, may find himself forced to share his insurance with others.

Types of Form. The form will in ordinary circumstances place the policy in one of the following five categories: (1) specific, (2) blanket, (3) floater, (4) automatic, (5) schedule.

Specific Coverage.—This policy is the most common form in use. It covers one kind of property in one definite location. When the building and contents are insured under a single policy, with definite amounts covered on each, the policy continues to be specific.

Blanket Coverage.—A blanket policy covers the same kind of property in different locations, or different kinds of property at a single location. Thus, several buildings in different locations may be insured under a blanket policy, as may stocks of goods or merchandise located in different warehouses or stores, or building and contents at a single location.

Floating Coverage.—A floating policy, termed in the insurance business "a floater," is used to cover goods in different locations when it is difficult or impossible to furnish an accurate description of location. One form of floater covers certain specific goods wherever they may be, usually within certain prescribed limits as to territory. For example, the personal effects, theatrical costumes, and equipment of a traveling stock company are located week after week and night after night in different hotels, theaters, trains, boats, automobiles, and terminals. A floater would cover this equipment wherever it might be, so long as it remained within the limits prescribed. Such limits might be a single state, the continental limits of the United States, or world-wide.

Automatic Coverage.—Automatic coverages are written with the so-called "reporting forms." They are used when it is difficult, if not impossible, to provide the insurance company with an accurate statement of values because of changes or fluctuations, yet when a full insurance coverage is desired. The term "thermostatic insurance" has been applied to this type of coverage because the amounts are automatically adjusted without action on the part of the insured as the amount of risk increases or decreases. The multiple location contracts utilized by chain stores fall within this category. So long as the required reports are accurately made within the limits of the policy, the insurance automatically adjusts itself to intervening inventory changes. The automatic builder's risk has the same effect. A build-

ing in the process of construction adds value day by day. Monthly reports are required, but a loss at a point between two reports will be protected by full insurance as the values of that day show.

Schedule Coverage.—Schedule policies are a variation of specific coverage. All the buildings belonging to an insured, with their contents, may be grouped on a single form, instead of on several forms, supplying specific insurance on each property. While specific amounts are indicated for each unit of the property, the policies as written cover proportionately every unit. An organization, such as a state, a municipality, a church with widely scattered properties, or a public utility company, frequently finds this form to be desirable as a means for simplifying the clerical supervision of insurance detail.

When a policy is written with a schedule form, the policy face covers pro rata on each item. It is, therefore, necessary for the insured to provide himself with policies aggregating the total set forth in the schedule, for he then knows that each item is covered for the full amount indicated. An enormous amount of detail work in checking a great many different forms and many expirations is by this means eliminated.

Clauses. Following the descriptive matter in the form, there are included a number of clauses modifying the policy conditions. These clauses differ with the character of the risk, being sometimes permissive, sometimes liberal, yet often restrictive in their nature.

Extensions and Limitations of Coverage. In a manufacturing or mercantile business it frequently happens that stock, running to considerable value, is delivered and is the property of the insured, but not actually within the premises described. A clause may be inserted in the form to extend the coverage on property, which is similar to that insured in the policy, while it is in cars on switches or sidetracks, when such cars are on the premises described or within 100 feet of buildings described in the policy. Likewise, similar goods in the open on the premises may be included within the scope of the coverage, as may goods on platforms in contact with buildings described and on sidewalks, streets, alleys, or detached platforms, when within 50 feet of buildings described in the policy.

When there is personal property in which parties other than the insured have an insurable interest, and when the insured's interest in the property is otherwise covered, such property is excluded from coverage, thereby eliminating a double insurance. As automobiles

are usually the subject of separate coverage, they, with all self-propelled vehicles and machines using gasoline, are therefore generally specifically excluded from coverage in the form.

Vacancy and Unoccupancy. Reference to the terms "vacancy" and "unoccupancy" in the policy indicates a difference in meaning between the two terms. A building is said to be vacant when it is empty, that is, when furnishings are entirely lacking and nothing, unless waste or rubbish, is contained therein. On the other hand, a building completely furnished is unoccupied if not tenanted in the customary way by human beings. Thus, a dwelling house entirely furnished, but closed, is unoccupied. It is vacant when the furniture has been removed.[1] Under the terms of the standard policy, a property vacant or unoccupied beyond a sixty-day period suspends the coverage during such further period as this situation shall continue. It is obvious that insurance on certain types of property would be of little use if this condition of the policy remained unmodified. Hence, in the forms used on the policies insuring summer or seasonal dwellings, it is necessary that a clause be inserted granting permission for the property to remain vacant or unoccupied for a portion of each year. While no limit is ordinarily set on a period of unoccupancy, vacancy is usually limited to a definite period, depending upon the nature and character of the property insured.

Alterations and Repairs. The question might arise as to, to what extent alterations and repairs in and about the premises insured might constitute an increase in hazard and thereby suspend the policy. To permit ordinary alterations and repairs, a clause has been devised for incorporation in the form. The clause not only permits such alterations but automatically brings within the scope of the insurance the alterations as they are made and also the materials and supplies that are being used in the work in or adjacent to the insured premises. No time limit is set for the accomplishment of the work.

[1] A building is not considered unoccupied if, for a temporary period, there are no human beings present. If the entire family leave a building for the day, it is not unoccupied. If it is being used as a dwelling, and at a customary time the members of the household habitually return, the dwelling is occupied. Likewise, a church may be without the presence of human beings for a considerable period of time, such, for example, as during the week, yet if used regularly for service, it is considered occupied. A school closed for vacation is not unoccupied if it is used during the school term. Caretakers are not ordinarily considered occupants, though a house kept open and in running order by servants, even though the owners have been for a considerable period elsewhere, is occupied. A building, dwelling or otherwise, to be occupied must be put to the actual and practical use contemplated by the parties.

The ordinary alterations and repairs referred to above do not include the reconstruction and enlargement of the property. Such repairs or alterations are termed "extraordinary." Permission for such alterations has a limit as to time, but, as in the case of ordinary alterations, the materials and supplies in or near the work are covered, as well as the extensions and additions themselves.

Manufacturing Privileges. It sometimes happens that a manufacturing operation requires gasoline, ether, or other inflammable substances that might void the coverage. To cover this situation, a work and material clause provides:

> Permission is hereby granted for such use of the premises as is usual, incidental and lawful to the occupancy as herein described and to keep and use all such appliances, devices, articles and materials (including such materials as are prohibited by the printed conditions of this policy) in such quantities as are usual and incidental to such occupancy.

If the policy is one that requires it, a night work clause provides: "Permission is given to work at all hours." Concerning the use of power, an electricity clause states: "Permission is given for the use of electricity for light, heat, and power in the premises described by this policy."

Permits. Obviously within the limits of this work a complete description of all available forms and clauses is impossible. Mention may be made at this point of a class of endorsements to which the term "permit" is applied. Innumerable permits are issued to cover special hazards, some without charge, and others for an additional premium.

The important thing for the insured to recognize is that a permit is very much a two-sided affair. The company does not state simply that something heretofore forbidden is now permitted. Rather it states upon what conditions it may be permitted. It is essential that an insured, who calls his insurance agent and gets permission to install a moving picture machine or a liquefied gas apparatus, or keep fireworks or other explosives, especially familiarize himself with the obligations that he has assumed in the way of a new set of conditions incorporated in his policy.

Concurrency. It is a matter of the utmost importance that policies designed to cover identical property be exactly alike as to form. When there are discrepancies in the coverage, the insurance is said

to be "nonconcurrent." Nonconcurrency may give rise to a duplication of insurance, enormously complicate the problem of adjustment, and bring results other than those contemplated when the insurance was written.

Nonconcurrency frequently makes its appearance following a verbal order for insurance with the details of policy writing left to the agent or broker. A misunderstanding may arise as to the extent or nature of coverage, and when there are a number of policies covering on a single risk only by the most careful checking may the insured be satisfied that his policies are concurrent. The danger may, to some extent, be averted by a carefully written order for insurance, though the safest procedure, if the number of policies is large, is to have the form to be used on the policy prepared in the office of the insured or at least approved by him prior to the insurance of the policy.

The question might naturally arise as to why care must be taken to guard against nonconcurrency when it is possible in connection with any risk to cover it under a single policy. Of course, if the risk is covered under a single policy there can be no nonconcurrency. The practice among insureds, however, of placing business with several agents or brokers results in their receiving as many individual policies. It is also the custom in the event of changing values to write new policies to increase a line and to cancel and rewrite existing policies for a lesser amount when a line is decreased. As a result of this practice in the business it is not unusual for an insured to find himself with a substantial number of policies covering for different amounts and expiring at different times during the year. It is evident that unless extreme care is taken the coverage may not be concurrent.

The following types of nonconcurrency are frequently found: (1) nonconcurrency as to type of form, one instance of which might be a blanket form on part of the policies, with the other written specific; (2) nonconcurrency as to coinsurance and average clauses; (3) nonconcurrency as to coverage, some forms being more inclusive than others, one policy perhaps covering the building and another including various additions or extensions; (4) nonconcurrency as to permits and warranties, various clauses and permits incorporated into one form being omitted in another.

For practical purposes, concurrency may be effected without resorting to a line-by-line and a word-for-word comparison of the policies. A clause or phrase may be worded to accomplish the same

purpose as another phrase worded in a slightly different manner. If the resulting coverage is identical, the insurance is concurrent.

So important, however, is this matter of concurrency that the careful insured will permit in his policies no differences, however slight. There is no reason, in the ordinary risk, why the policies should not be identical. This is the ideal situation, and its attainment should be insisted upon. Large corporations and others whose needs are not readily met by the available forms secure concurrency by having the form they require drawn up by their insurance advisers and then printed. This printed form is distributed to all agencies writing on the line, and the use of no other is permitted.

Demolition Insurance. It has become the custom of municipalities through the adoption of building regulations to demand that buildings erected within designated sections of a city meet prescribed specifications. It is sometimes made mandatory that destruction by fire or other cause of a major part of a nonconforming building, usually one-half, be followed by its complete removal.

Where such a law exists, a building burned with over 50 per cent destruction, so far as its owner is concerned, is a total loss. When the policy has not been worded to meet this contingency, or an endorsement provided for the same purpose, it has been held that the fire is the cause of the entire loss and, therefore, must be borne by the insurers. Again, it is sometimes mandatory that more substantial or expensive construction be used in restoring the damaged parts. Unless the contract of insurance especially disclaims liability for this additional cost, as does the New York policy, it is held properly to be an insurance loss. In states where there is no disclaimer of liability in the policy, and where the law permits, the insurers have adopted a clause accomplishing the same end.

If demolition insurance is desired, the coverage is effected by attaching the demolition clause to the fire policy. The liability of the company under the clause does not exceed the value of the buildings prior to the loss or damage. In other words, the policy does not undertake to provide funds to replace the entire new building to comply with the building requirements, though it may be written to include cost of clearing away wreckage.

Smudge Damage. It has already been noted that to provide cover against loss under the standard fire policy, the loss must be caused by an unfriendly fire. Smudge damage, the result of an unfriendly fire,

is covered by the fire policy. Because of this, it frequently follows that insureds believe all smoke damage to be covered regardless of its origin. This is not the case, and frequently misunderstandings are the outgrowth of smoke damage caused by improperly operating heating plants, particularly if fired by oil burners. It sometimes happens that a heavy smoke or smudge escapes from the boiler or furnace, doing severe damage to the property. The fire is contained within the boiler or furnace and, therefore, remains a friendly fire, and the smudge or smoke damage is, therefore, not a fire loss.

Extended cover contracts provide for this coverage; but not infrequently insureds do not care to buy all the forms of protection afforded by the extended cover endorsement and, therefore, provide for smudge damage by endorsement to the standard fire contract. The smudge damage endorsement now in general use includes smoke damage from stationary heating plants, regardless of the fuel used. In the case of dwellings, endorsements are sometimes issued providing coverage from stoves and other cooking apparatus as well as from central heating plants. When elaborate interior decorations are involved, such as in clubs, churches, theaters, and the like, insurance companies will in the ordinary course accept the risk only after inspection and the promulgation of a special rate.

Charges for Fire Apparatus. Many valuable properties are situated outside the limits of towns or cities where fire departments are located. Summer residences particularly, located on isolated islands, in the woods or mountains, frequently involve many thousands of dollars in value that could be saved when fire threatens by calling for the assistance of the fire department of a neighboring community. Country estates, farms, isolated filling stations, stores, and other types of secluded property, all fall in the same category. Forest fires, grass burning, or a fire breaking out in a neighboring property may each be the occasion for summoning help. If the neighboring fire department is called in time, it may succeed in warding the fire from the threatened premises, save the owner his property and the insurance companies from paying a total loss. This expense, however, regardless of the fact that insurance companies may be beneficiaries of the action, is not covered in the policy unless the risk is specifically assumed.[2] Fire insurance companies will endorse a fire policy to in-

[2] Fire departments are supported by the taxpayers of the community in which they are located and expect and demand remuneration if called to assist neighboring property

demnify the insured for fire apparatus charges when the coverage is deemed desirable.[8]

Perils Not Covered. It is specifically provided in the New York standard policy that the company shall not be liable for loss by fire or other perils insured against caused directly or indirectly by:

(a) enemy attack by armed forces, including action taken by military, naval or air forces in resisting an actual or an immediately impending enemy attack; (b) invasion; (c) insurrection; (d) rebellion; (e) revolution; (f) civil war; (g) usurped power; (h) order of any civil authority except acts of destruction at the time of and for the purpose of preventing the spread of fire, provided that such fire did not originate from any of the perils excluded by this policy; (i) neglect of the insured to use all reasonable means to save and preserve the property at and after a loss, or when the property is endangered by fire in neighboring premises; (j) nor shall this Company be liable for loss by theft.

While the terms of the policy definitely exclude the aforementioned perils, they can be, and frequently are, the source of great loss and damage. To meet the requirements of insureds who require more complete coverage than that contemplated by the policy as written, certain supplemental contract forms have been prepared.

Explosion Damage. Just as combustion may proceed at a rate too slow to cause a fire, it may also proceed at a rate so fast as to cause an explosion. The courts have held that concussion damage caused by an explosion is not a fire loss, and this was held previous to the inclusion in the standard policy of the explosion exemption clause. The New York standard policy, it has already been noted, has in-

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owners. Sometimes the selectmen of the town will assume the responsibility for sending for help in case of fire, and the bill will become a public charge. This, however, is frequently not the case, and the expense must be paid by the property owner who sends for the help and whose property is threatened. The cost ranges from $25 or $50 in some communities to several hundred dollars a day in others. In one instance where fire apparatus and men were transported by steamer to an island off the Maine coast to help control a fire, the charge was nearly $1,000. Twenty-five dollars an hour for a motor pumper and a dollar an hour for each man is not unusual.

[8] The policy definitely places an obligation upon the insured to use all reasonable means to save the insured property when threatened by fire. Because of its inclusion, the clause is held to impose no additional liability upon the insured, since such a duty is said to arise from the nature of the insurance contract. The extent to which an individual is bound to go is that prompted by reason. For example, it has been held that if the duty of caring for a family or saving a life prevents the care of threatened property, the insured is not to be charged with negligence in devoting his entire attention to the former at the expense of the property. However, an insured may not sit complacently by and watch his property burn without expending such effort as in the circumstances seems reasonable. Authorities agree that under the New York policy the insurer is not liable for expenses incurred either in protecting property from threatened fire or even in putting the fire out when discovered.

corporated a clause which states that unless coverage is endorsed upon the policy, the insurer shall not be liable for damage caused by explosion except when fire ensues, and in that event he shall be liable for the loss or damage caused by the fire only.

It has been held formerly that if a fire follows an explosion, it is the explosion and not the fire that is the proximate cause of the loss, and the fire insurance company is not liable. The policy as it now reads, however, exempts concussion damage but includes fire damage. It is to be pointed out that, in computing the loss, the condition of the property after the concussion must be considered. The fire policy is liable only for the loss which the fire causes to the property already damaged by explosion.

When an explosion is an incident to an unfriendly fire already in progress in a building, the explosion damage is now held by most authorities to be a result of the fire, and the entire damage, whether caused by fire or concussion, is said to be properly a fire loss.

Losses caused by the explosion of water-heating coils in ranges and boilers, by the explosion of hot water tanks or other like installations are not properly losses assumed by the standard fire policy, unless the coverage is specially endorsed thereon.

In connection with exposure losses, there is a point to be considered. If an unfriendly fire in progress is the cause of an explosion, fire is considered the proximate cause of the loss caused by both the explosion and the fire on the premises where the explosion occurs. But, if the concussion from this same explosion is severe enough to break neighboring windows or cause an adjoining building to collapse, the loss to the adjoining property is deemed to be a concussion loss, caused by an independent explosion, and not a fire loss. Hence, the same explosion may do damage covered by one set of fire policies and not by another.

When the explosion is an incident to a fire on the premises destroyed, it is to be emphasized that the fire must be an unfriendly one; it makes no difference how unfriendly the explosion may be, or whether its accidental nature can be demonstrated without question. It is essential that it be an incident of which an unfriendly fire is the proximate or controlling cause before it becomes a matter of liability for the fire insurance carrier. Thus, it has been held that if a clerk in a store lighted his way into a dark cellar with a match, and the flame came into contact with gasoline vapor, the fire insurance would not be

liable for the collapse of the building caused by the ensuing explosion. A similar case involves lighting a match in a basement filled with illuminating gas. In both instances, the person lighting the match did exactly as he intended. The fire was a friendly one. Therefore, the damage caused by the explosion was not a loss to be paid by the fire insurance.

Explosion insurance, as has already been noticed, may be provided by adding the coverage to the fire policy. This form is most convenient when the amount of explosion insurance and the amount of fire insurance needed are the same, or when the explosion hazard is so remote that the charge therefor permits inclusion with the fire coverage at a reasonable cost. There are other instances where the amount of the fire insurance far exceeds any possible explosion damage, yet where the explosion hazard is very real. In this second instance, it may better meet the needs of the insured to provide the explosion coverage by the use of a separate explosion policy.

Explosion Insurance. To cover the explosion hazard, a specific coverage is necessary. Explosions caused by steam pressure cannot be covered by the policy written by the fire insurance companies. Therefore, the explosion policy written by fire companies specifically excludes loss or damage by explosion originating within steam boilers, pipes, flywheels, engines, and machinery connected with or operated by steam boilers. Explosions caused by steam pressure are covered by steam boiler policies; engine breakdown and flywheel explosion policies written by casualty companies are to be noticed in due course. Another exclusion to be found in the policy, but one which may be eliminated, relates to the blowing up of buildings by order of civil authorities.

The explosion policy provides indemnity in the event of loss or damage caused, with the exceptions above noted, by explosions of every conceivable cause. Included besides inherent explosion hazards are explosions outside the premises, whether the damage is due to concussion or to flying materials resulting from explosions, and finally, explosions of malicious origin, such as bombing or dynamiting.

Explosion coverage is sometimes included in the fire coverage on risks such as grain elevators, flour mills, and the like. Such coverage is usually limited to hazards incident to the business, and therefore is less broad than the separate policy. Sometimes to complete the pro-

tection in such cases, the external, or "off premise," hazard is separately insured.

Explosions are violent affairs, and frequently the damage done extends to property other than that owned by the insured. The explosion policy, as usually written, covers only the property of the insured, but a specific amount may be written as explosion liability. This form covers the legal liability of the insured for damage to the property of others by explosion. The coverage is also written by the casualty companies.

Riot and Civil Commotion Insurance. The riot and civil commotion policy, as now written, extends the coverage of the ordinary explosion policy to include all losses from riot, including fire damage caused by riot. The most fertile source of loss from riot is strikes, and the coverage has sometimes been termed "strike insurance." The term "strike" now finds only an incidental place in the policy.

Exactly what constitutes a riot is not subject to ready definition. The policy itself contains no definition of riot; therefore, to determine the extent of the coverage in a particular situation, the insured must rely upon the statutes of the jurisdiction or the decisions of the courts. The statutes vary. Some require to constitute a riot that there must be tumult, or breach of peace, only if the act is lawful. It is generally conceded, however, that there is a riot if at least three or more persons do an unlawful act with force or violence against the person or property of another, or do a lawful act in a violent and tumultuous manner. In some states the statutes indicate a riot, in the foregoing circumstances, if two or more persons are involved. Since a mob, within the limits of the foregoing definition, might damage property in the night, in the absence of witnesses, it is important to emphasize that the burden rests upon the insured to prove that loss is, in fact, the outgrowth of a riot. Damage done by a group of vandals entering a plant stealthily, according to recent decisions, does not come within the scope of insurance covering riot damage.[4]

The policy covers direct loss or damage to insured property because of: (1) riot, riot attending a strike, occupation of property by striking employees, civil commotion, and fire caused thereby; (2) explosion from any cause, accidental or malicious, originating on or

[4] *International Wire Works* v. *Hanover Fire Insurance Company,* 283 N.W. 292; *Walter* v. *Northern Insurance Company,* 18 N.E. (2d) 906.

off the premises of the insured, except explosion originating within steam boilers, engines, and machinery. The coverage of glass breakage is limited to 10 per cent of the value of the building. The protection against fire afforded by this policy is most important since fire insurance policies exclude loss or damage caused directly or indirectly by riot or civil commotion. The fire coverage in this contract is one of the impelling reasons for carrying the insurance. Theft is not covered by the policy, but a pillage and looting clause may be incorporated into the form, and, when this is done, theft losses occurring during and at the immediate place of the rioting are covered. By endorsement, the policy may be extended to consequential losses, such as profits, commissions, rents, rental value, leasehold interest, and the like. Property destroyed during a conflagration by order of civil authority is not covered in the policy, but for a small additional premium this coverage may be endorsed on the contract.

The policy cannot be canceled until the expiration of ninety days from the date of the inception of the coverage. This precludes the possibility of ordering a policy in the event of threatening trouble and canceling it within a few days after the clearing up of the threat. After ninety days it may be canceled by either party on the same terms as the fire policy.

Coverage may be provided on an annual basis, or the insurance may be written for a term. Rates are based upon occupancy and construction. Fireproof structures take the lowest rate; the second classification includes all other properties. This classification, based upon the construction of the building, is the outgrowth of the fact that the policy covers fire damage. Rates are based upon normal conditions and, in the event of threatened disturbances, are trebled. The Explosion Conference may declare that emergency conditions apply to an entire territory or to an entire industry. The manual provides that trebled rates shall apply as follows: (1) to the entire municipality, (*a*) when the police, fire, or water department employees have gone on strike or announced their intention to do so, or (*b*) when the Explosion Conference declares that emergency conditions exist; (2) to the individual risk, when its employees have gone on strike, or walked out, or been locked out, at the time application is made for insurance. A strike is considered as existing when any number of employees of a plant quit work by concerted action to enforce some

demand or to protest against some act or condition. It is to be pointed out that trebled rates apply only to new business. Insureds who carry the policy continuously through normal times are not faced with trebled rates when trouble threatens.

War risks are excluded under the riot and civil commotion form, but sabotage losses may be covered under an extension known as the "vandalism and malicious mischief endorsement." This endorsement does not add insurance but extends the riot and civil commotion policy to cover unlawful physical damage caused by acts of racketeers, disgruntled employees, or others bent on any form of sabotage. Because of this, the contract is sometimes known as "sabotage insurance."

Losses caused by acts of sabotage of the agents of any government or faction engaged in warlike operations, when such agents are acting secretly and not in connection with any operation of the military or naval forces in the United States, may be covered under a broad form developed since the commencement of World War II. A limited form is also available giving essentially the same coverage as that obtainable under the broad form, with the exception that malicious damage by foreign government agents is excluded.

The vandalism endorsement does not cover consequential losses, such as spoilage due to interruption of a process, the malicious turning off of heat, or the interruption of refrigeration or other like consequential losses, though the coverage may be provided by endorsement of the policy. Since the riot and civil commotion policy of itself does not cover consequential losses, where such coverage is of importance, the inclusion of the vandalism endorsement affords a means for extending the policy to include consequential losses.

War Risk Coverage. In the ordinary course of events, the provision in the policy excluding coverage for losses caused by military or usurped authority is a cause for very little concern. With the advent of hostilities and the increased probability of losses growing out of bombardment, the risk becomes a very real one, and a demand for suitable insurance is manifested. During World War I, a form was provided designed to furnish a comprehensive war risk protection. The coverage was ordinarily provided by writing an explosion policy with an endorsement incorporating the war risk features into the policy. With the advent of World War II and the development of

long-range bombing aircraft, the need for war risk insurance was intensified, and the insurance companies developed a special cover known as "war risk and bombardment insurance."

The policy covers losses caused by war; invasion; civil commotion; insurrection; rebellion; revolution; military or usurped power; naval or military bombardment; and aerial craft, whether hostile or not, while engaged in active war service during wartime. The coverage includes losses caused by bombs, shells, or missiles and covers fire or explosion directly caused by any of the foregoing perils.

With the declaration of war with Japan, followed by similar declarations with Germany and Italy, insurance companies began to withdraw from the writing of bombardment risks. They found that it was impossible to obtain a spread consistent with sound underwriting. There was a tendency to create a demand for insurance in areas where it was felt the risk was great and to write no insurance in the other areas.[5] The outcome of this situation was the development of the War Insurance Corporation, created by the Reconstruction Finance Corporation with a capital of $100,000,000 and designed to provide insurance for property owners against war "damages to or destruction of buildings, structures and personal property including goods, growing crops and orchards." Not all private insurers, however, withdrew from the business, and a substantial volume of bombardment business was written by commercial insurance companies.

FOR REVIEW

1. A number of strikers enter a plant with guns and hold their employers at bay. There is no disorder, but considerable damage is done by the strikers. In your opinion is the damage covered under the riot and civil commotion policy?

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[5] While not representative of all insurance companies, the attitude that land war risk was not a proper subject for private insurance became more and more accepted. The company executives' attitude was expressed in the form of an assent to a telegram sent them by President Paul L. Haid of the Insurance Executives Association. This telegram read as follows:

"The trustees of the Insurance Executives Association are unanimously of the opinion that during active hostilities involving this nation, loss or damage on land by war, invasion, bombardment and military or usurped power is not a proper subject for private insurance for the reason that probable catastrophe loss thereunder threatens adequacy of protection against normal hazards held by existing policyholders.

"It is felt that only the government of the United States is able to assume the obligation of indemnifying its citizens against such loss or damage on land caused by foreign enemies. Please wire promptly to the undersigned whether you subscribe to the foregoing views and favor appropriate representations being made without delay."

2. During a strike, employees enter a plant by stealth and destroy a considerable amount of property. There is no evidence to show whether the damage was done by one man or several. Is the loss covered under the riot and civil commotion policy?
3. The dwelling of A was struck by lightning. The next day the fire adjusters refused to recognize a claim, stating that there were no marks of fire anywhere such as were usually to be found when lightning has come in contact with dry wood. Are the fire companies liable?
4. The dwelling house of X is in danger of loss by fire because of sparks falling from a neighboring fire. A representative of the insurance company that covers the dwelling of X is at the scene of the fire. X suggests that wet blankets on the roof might save the building and the agent agrees. Later when X presents a claim for the value of the blankets the company denies liability. In your opinion has X a claim?
5. Is a factory covered against an explosion that originates in an adjoining building under the simple explosion insurance form?
6. A policy is delivered to X covering "On building and contents." X contends the description to be too vague and wishes the contents item to enumerate in considerable detail the items and classes of items to be covered. What is your opinion as to the best practice?
7. A church located on the corner of Hammond and Main streets in Bangor has three addresses, one that appears in the church records, one that appears in the city directory, and one that appears in the records of the city street department. In writing the policy which number should be used?
8. B purchases a store adjoining his present property. The present property is numbered 118, and the new property is numbered 120. He breaks through the wall and merges the two stores into one. He closes the entrance to 120, and his mailing address is known as 118. Will his policies cover both 118 and 120?
9. B carries insurance on his plant covering among other risks the risk of riot and riot attending a strike. A sit-down strike develops to the end that his plant is seriously damaged. Under the definition of riot would this damage be covered by the policy?
10. As a result of a celebration after a football game the interior of a theater is virtually destroyed. The owner of the theater carries a policy covering against damage caused by riot or civil commotion. X tells him that his policy will not cover because the damage was not caused by a riot having an unlawful objective. What is your opinion?
11. B carries a riot and civil commotion policy, and as a result of a riot a pipe line from a refrigerating plant is broken causing a damage to the pipe line of $200. However, there is a damage to the contents of the refrigerating plant of $50,000. Discuss the liability of the company.
12. Three men secure a pass key and in the night surreptitiously enter the plant of X and sabotage vital machinery. The object is illegal, and there are three men operating in concert. Is this loss covered under the riot policy?
13. The word "sabotage" it is well known comes from the French word *sabot.*

The French millworker wishing to stop operations in a plant found it possible to do this by wedging his wooden shoe in the moving parts of a loom. In the modern plant a belt cut, a vital part of a machine secretly removed, gears broken, and the like effects the same thing. Charters authorizing the writing of insurance rarely cover the risk of sabotage yet sabotage losses are insured. How can this be done without the companies accepting the limitation set forth in their charters?

14. The X company carries a war risk and bombardment policy. An explosion cripples a plane, and it is later found that two enemy agents secretly entered the plant and placed a time explosive that caused the damage. Is this in your opinion a risk covered by the policy?
15. Policies are sometimes written to read: "John Doe, on his interest in, etc." Is the insurance valid in such an instance if John Doe is not the sole and unconditional owner, or must John Doe's interest be specifically described? Give reasons for your answer.
16. If a steam-heating plant were operating under normal conditions and a steam radiator should crack, causing damage to the premises, would this be covered under an explosion policy?
17. Under an explosion policy, would the explosion of a hot-water heater be covered?
18. Would the explosion of a heating boiler in a residence be covered under an explosion policy?
19. B operates a tire store and, as a part of his business, does vulcanizing work. He carries an explosion policy. As a result of an explosion, damage to his building is serious. The policy covers the damage, but the question arises as to whether it also covers the loss to the vulcanizer that caused the damage.

Chapter XV

CLAUSES LIMITING INSURER'S LIABILITY

Of Great Importance. Clauses containing special warranties designed to limit the liability of the insurance carrier are incorporated into insurance forms. These clauses sometimes carry with them a reduction in the rate at which the policy is written; sometimes the use of one or more of the clauses is mandatory in connection with a particular form or coverage. Because of their frequent use, it is essential that the obligations they place upon the insured and their operation be thoroughly understood. Failure to understand the effect of the clauses may result in an improperly balanced insurance program.

The Coinsurance Clause. The coinsurance clause has for its aim a control of the amount of insurance the insured shall carry. It effects this control by limiting the liability of the insurance company to that proportion of the loss which its amount at risk bears to a given percentage of the value of the property at the time of the loss or damage. A number of clauses, seeking to accomplish the same purpose and having the same general meaning, have been devised. To these a number of different names have been applied, such as the average clause, contribution clause, percentage coinsurance clause, reduced rate average clause, reduced rate coinsurance clause, and reduced rate contribution clause. Because of the common use of a requirement of insurance equal to 80 per cent of the value, it is common practice to refer to the clause as the "80 per cent clause," or sometimes as the "80 per cent coinsurance clause."

The coinsurance clause in common use at the present time is termed the "reduced rate contribution clause." In its present form it makes no requirement concerning the amount of insurance that the insured must carry, but rather states the proportion of the loss the insurer is obligated to pay. This condition is made part of the contract for a special consideration. This consideration takes the form of a reduced rate, granted to compute the premium charge for the policy. The following clause is one now used:

> In consideration of the reduced rate and (or) form under which this policy is written, it is expressly stipulated and made a condition of this contract that in

the event of loss this Company shall be liable for no greater proportion thereof than the amount hereby insured bears to . . . . % of the actual cash value of the property described herein at the time when such loss shall happen, nor for more than the proportion which this policy bears to the total insurance thereon.

In the event that the aggregate claim for any loss is both less than ten thousand dollars ($10,000.00) and less than five per cent (5%) of the total amount of insurance upon the property described herein at the time such loss occurs, no special inventory or appraisement of the undamaged property shall be required.

If this policy be divided into two or more items, the foregoing shall apply to each item separately.

The last two paragraphs of the foregoing clause are not, in fact, a necessary part of the coinsurance clause, but are invariably made a part in general practice. Their effect in connection with coinsurance will be noticed in due course.

Reason for Coinsurance. Insurance undertakes to shift the burden of risk from the shoulders of the individual, through a distribution of the cost of risk, among a great many. Since a fire in a property need not destroy it totally, and since fire losses vary in degree, there being a great many small losses as compared with the number of total losses, unless each insured carries an adequate percentage of insurance to value, the burden of risk will not be equitably distributed.

Insurance premiums have been compared to a tax rate. In every community, taxes to defray community expenses are raised by an assessment levied upon property valued by assessors for that purpose. It is pointed out that if each individual were to indicate a value upon which he was willing to be taxed, the benefits, if equally distributed, would bear heavily upon some and lightly upon others. So in fire insurance, if one individual pays on a low percentage of his total value and another pays on a high percentage, experience shows that the latter pays proportionately more for the protection he receives. If one insured insures in the amount of 50 per cent of his value, another 20 per cent, a third 80 per cent, and a fourth 90 per cent, while a fifth insures for full value; and if each receives his loss paid in full up to the face of his policy, those carrying the small amount of insurance to value pay less than their share of the average premiums. To create an equitable situation, the amount of insurance to value carried by each insured should be uniform. The coinsurance clause requires that the insured carry insurance to a certain stipulated percentage of value or, failing to do so, bear a percentage of the loss.

A mathematical illustration of the foregoing statement is to be found in a report submitted to the legislature of the state of New York on February 1, 1911, by what is generally referred to as the "Merritt Committee." Drawing upon statistical data, the committee presented a statement of the average 100 losses to every $100 worth of buildings in a given class. The losses are divided into ten groups. The first group comprises those properties where the losses involved less than 10 per cent of the values. The second group includes those that exceeded 10 per cent and were less than 20 per cent, and the third group those that exceeded 20 per cent and were less than 30 per cent, and so on through the ten groups. The report indicated that every 100 fires burned $916 worth of property, where each property had a value of $100.

The losses in each group were distributed as follows:

On the average, of every 100 fires there are:
82 that do a damage of less than $10;
6 that do a damage of less than $20 and more than $10;
3 that do a damage of less than $30 and more than $20;
2 that do a damage of less than $40 and more than $30;
1 that does a damage of less than $50 and more than $40;
1 that does a damage of less than $60 and more than $50;
1 that does a damage of less than $70 and more than $60;
1 that does a damage of less than $80 and more than $70;
1 that does a damage of less than $90 and more than $80;
2 that do a damage of less than $100 and more than $90.

The statistics further show that if the amount of insurance on each building had been $10 for every $100 of value, the 100 losses would have cost the insurer $344, or 34.4 per cent of the insurance. The following table shows losses for different values covered:

Insurance	Loss	Percentage of Insurance	Rate Should Be
$ 10	$344	34.40	$0.34
20	488	24.40	.24
30	593	19.77	.20
40	673	16.82	.17
50	738	14.76	.15
60	793	13.22	.13
70	838	11.97	.12
80	873	10.91	.11
90	898	9.98	.10
100	916	9.16	.09

It is obvious from the foregoing statistical data that the insured

carrying the small amount of insurance to value should pay a much higher rate for his protection than the insured who carries full, or nearly full, value.

The coinsurance clause is the simplest method devised to effect an equitable adjustment of charges on the basis of the insurance carried. The rate is fixed upon the assumption that insurance to value will be carried or a predetermined percentage to value. The coinsurance clause makes it necessary that for full protection the insured carry the percentage of insurance contemplated in the rate. To do otherwise, he himself becomes a coinsurer of his own risk and must contribute to the payment of his own loss as the deficiency in the amount of insurance he carries bears to the amount contemplated by the clause.

Operation of Coinsurance. While the coinsurance clause does not make mandatory the carrying of insurance up to a specified percentage of value, losses are adjusted as if insurance in such an amount were carried. Where there is a deficiency, the insured is said to be carrying that amount of risk himself and is, therefore, a coinsurer to the extent of the deficiency.

Thus, if the owner of a property valued at $100,000 insures his plant in four companies, each covering for $20,000, with the 80 per cent coinsurance clause, in the event of a loss each company will bear its proportion of the loss, but limited to that proportion which the amount insured bears to 80 per cent of the value. Since 80 per cent of the value is $80,000, and the amount of each policy is $20,000, the proportion of the loss each policy pays is one-fourth. In a $10,000 loss, each company would pay $2,500, and the loss would be paid in full.

But the insured is penalized if he carries inadequate insurance. With the $100,000 value mentioned above, assume that the insured carries three $20,000 policies, instead of four. The percentage that each policy pays remains unchanged, and in a $10,000 loss each company pays one-fourth, or $2,500, making the total collected under the $60,000 insurance $7,500.

To express the foregoing example in its simplest terms, assume, as before, a property valued at $100,000 with one policy covering for $80,000 and written with 80 per cent coinsurance. Since the amount of the insurance is equal to 80 per cent of the value, any loss up to the face of the policies is paid in full. In the case of a $20,000, $40,000,

or $50,000 loss, these respective amounts are paid to the policyholder. In the case of a $90,000 loss or a total loss, the policyholder collects $80,000, the face amount of his insurance. There is nothing in the coinsurance clause that limits the amount of insurance, and the insured may carry full insurance to value if he elects to do so, in which event all losses are paid in full.

In the foregoing case assume, as before, $100,000 value, and one policy for $40,000. Since the insurance company is obligated to pay only that proportion of a loss which the amount insured bears to 80 per cent of the value, and since the amount insured is half of 80 per cent of the value, the insurance company is liable only for one-half of any loss. The liability, as before, is limited by the face of the policy. Thus, in a $20,000 loss the liability is $10,000; in a $40,000 loss the liability is $20,000; and in a $50,000 loss the liability is $25,000. In a total loss of $100,000, one-half the loss would be $50,000, but since the face of the policy is $40,000, that amount represents the limit of the company's liability.

The operation of the clause may be expressed in the following formula:

Let L = loss,
I = insurance,
P = percentage indicated in clause,
V = sound value at time of loss,
X = amount the insurance company pays.

Then $X = \frac{LI}{PV}$.

In the operation of the foregoing formula it is to be remembered that the insurance companies are never liable for an amount in excess of the policies, and hence if X exceeds the insurance, the companies are liable only for an amount not in excess of the total insurance.

Thus, in the example indicated above, if

$L =$ $10,000,
$I =$ $40,000,
$P =$ 80%
$V =$ $100,000,

Then $X = \frac{\$10,000 \times \$40,000}{80\% \times \$100,000} = \frac{\$400,000,000}{\$80,000} = \$5,000.$

$X =$ $5,000, the amount the insurance pays.

Expressed in another way, if we state that the insured is required to carry a certain amount of insurance (whatever the percentage stipu-

lated in the clause may be) in order to avoid becoming a coinsurer, we may state that the insurance will pay no greater proportion of any loss than the total insurance bears to the percentage of value required. Thus, with $40,000 total insurance on a $100,000 value, the insured can collect no more than $40,000 bears to 80 per cent of $100,000, or $80,000. Since $40,000 is one-half of $80,000, the limit of the amount of loss payable by the insurance is one-half. Thus, in a loss of $50,000 the insurance pays $25,000, and the insured becomes a coinsurer for the balance.

It is frequently stated in insurance literature that when the loss is total, the coinsurance clause is inoperative. This statement is not correct. The clause is operative in every loss. However, when the loss is total, the percentage of the loss that limits the amount the insurance is required to pay will exceed the face of the policies. Therefore, because the full amount of the policies is payable in the event of

TABLE 2

Value of Property	Insurance Required 80%	Insurance Carried	Loss	Insurance Pays Not Over	Insureds Must Contribute
$125,000	$100,000	$ 10,000	$50,000	1/10th	$45,000
125,000	100,000	20,000	50,000	2/10ths	40,000
125,000	100,000	30,000	50,000	3/10ths	35,000
125,000	100,000	40,000	50,000	4/10ths	30,000
125,000	100,000	50,000	50,000	5/10ths	25,000
125,000	100,000	60,000	50,000	6/10ths	20,000
125,000	100,000	70,000	50,000	7/10ths	15,000
125,000	100,000	80,000	50,000	8/10ths	10,000
125,000	100,000	90,000	50,000	9/10ths	5,000
125,000	100,000	100,000	50,000	In full	0
125,000	100,000	110,000	50,000	In full	0
125,000	100,000	120,000	50,000	In full	0
125,000	100,000	125,000	50,000	In full	0

a total loss, the impression follows that the clause is inoperative. This is illustrated by the following figures. In the foregoing case, when the sound value at time of loss was $100,000, and the insurance $40,000, it was shown that the liability of the insurers did not exceed one-half the loss. When, however, the loss was total, or $100,000, one-half the loss exceeded the insurance; hence, the policies pay up to the amount for which they were written, or $40,000. The company, of course, is never liable for a greater amount than the amount for which the policy was written. Table 2 will illustrate the operations of the clause where different amounts of insurance are involved. It will be seen that when the insured carries the amount of insurance

required, he is paid in full for all losses up to the face of his policies Nor is he limited to the percentage stipulated in the clause. He may carry insurance in excess of 80 per cent, or 90 per cent, or whatever percentage is indicated, up to full value.

A thumb rule to determine the operation of the clause might be expressed as follows: (*a*) determine the amount of insurance required by the clause in order not to be a coinsurer; (*b*) ascertain the amount of insurance actually carried; (*c*) find what proportion the insurance carried bears to that required; (*d*) apply this proportion to the *loss*. Thus, if under (*a*) the amount found is $10,000, and under (*b*) the amount is $5,000, then (*b*) is one-half of (*a*). Consequently, the insurance pays one-half of any loss up to its face value.

The Waiver Clause. Incorporated into the reduced rate contribution clause is the so-called "5 per cent waiver clause." As a matter of fact, it is a clause entirely separate and apart from the coinsurance clause and need not be used. Practice, however, has so associated the two that one is commonly considered to be a part of the other.

The purpose of the waiver clause is to relieve the insured of the necessity of taking a physical inventory of the undamaged property in the event of small losses. It is to be emphasized that the clause in no way suspends the operation of the coinsurance feature of the contract. It merely relieves the insured of the burden of verifying by an actual inventory at the time of the loss or damage the figures as shown on his books. This warning is necessary because of the misapprehension, frequently voiced, that small losses are outside the operation of the clause. Such is not the fact, and even though an inventory is not taken, if the figures as submitted show insufficient insurance to value, the insured becomes a coinsurer, regardless of the size of the loss.

Problem of Valuation. Since the amount for which the insurer is liable is dependent upon a percentage of the actual cash value of the insured property at the time of the loss or damage, it is immediately apparent that the question of valuation is of the utmost importance. Moreover, so far as values are concerned, the entire burden is placed squarely upon the insured.

In connection with stocks of merchandise there is little difficulty. When inventories are carefully taken, and old stock is properly depreciated, the value of an inventory within reasonable limits can be ascertained through the record of purchases and sales. It is impor-

tant to emphasize, however, that in connection with a business enterprise whose business has sharp seasonal inventory increases, insurance written with the reduced rate contribution clause should be adjusted to meet these seasonal advances. Retail stores, as a rule, add considerably to their stock just before the Christmas holiday season. If their insurance is adjusted to meet their average needs throughout the rest of the year, a fire during the period of the high inventory value might result in the insured's unwittingly becoming a coinsurer.

Again, if the merchandise insured is a commodity with a shifting market and large values are involved, the insured must carefully follow quotations affecting his goods and adjust his insurance to cover any market appreciation. It makes no difference that the insurance to value was correct when the policies were issued. The adjustment will be effected upon the basis of values at the time of the loss.

In the case of machinery and fixtures there is little occasion for difficulty. Values are reduced each year through charge-offs made for depreciation and obsolescence. However, when the value used for insurance is the book value, care must be exercised that this value represents the actual value. In other words, it sometimes happens that an extremely conservative depreciation program will result in carrying fixtures and machinery below their actual cash value. While the books of account may serve as evidence to indicate value, they are by no means conclusive. An adjustment contemplates actual cash value, not book value. It is to be presumed, however, that in most cases the two will coincide within narrow limits.

Real estate affords the most difficult problem in valuation. Because of changing wage scales, material prices, and other market factors, building values are constantly fluctuating. The price trend is slow, and for that reason deceptive. A ten-year-old factory building that cost $100,000 and depreciated each year on the company's books, may, as an actual fact, have a depreciated replacement value far in excess of the original cost. Thus, an insurance program based upon the original cost, less depreciation, might be nothing less than disastrous.

A difficult problem is presented when market value and replacement value differ widely. Economic changes in communities result in properties being offered for sale at a fraction of their replacement cost. Where the market value is very much below the replacement value, the question of coinsurance becomes confusing. If a building

would cost $40,000 to rebuild, yet sold for $10,000, how much should be carried to avoid becoming a coinsurer? The answer is, of course, that because of economic obsolescence, depreciation, and changing neighborhood conditions the building has lost 75 per cent of its replacement cost. Its insurable value is $10,000. A partial loss will have to be replaced upon a basis of new construction. It is, therefore, the part of wisdom to eliminate the question of values for coinsurance purposes and write such a risk flat. Careful underwriters are reluctant to incorporate a coinsurance clause into a form covering any building when the depreciation, however caused, exceeds 40 per cent.

Again insureds may let themselves into a difficult situation by taking extreme depreciations on their books and establishing low values so that they may benefit by the lower coinsurance rate and yet carry as little insurance as possible. Occasionally an unscrupulous insurance solicitor will endeavor to show an insured carrying flat insurance that he is being overcharged for the protection. To avoid the necessity of adding large amounts of insurance in changing from flat to 80 per cent coverage, the insured is told to depreciate his property heavily. By following such an ill-advised suggestion he places himself, in the event of a substantial partial loss, squarely between two choices, either of which will injure him. He must, if a loss occurs, prove to the insurance adjuster that his values are as low as he contends they are, or he will become a coinsurer.[1]

Property Exclusions. While an insured may secure a reduced rate by incorporating the reduced rate contribution clause in the form under which his property is insured, it does not always follow that a change from a flat rate coverage to a coinsurance coverage will result

[1] Suggested annual rates of depreciation, in their particular application, are subject to a considerable degree of modification. The care of the particular building and the operation of the forces that cause depreciation must in each case be considered. A type of building whose life is estimated at fifty years might well be considered at the end of twenty years to be 40 per cent depreciated. Some economic change in manufacturing process or in consumer demand might make the building and plant almost useless. On the other hand, favorable developments might eliminate entirely the element of economic obsolescence, and the element of depreciation be limited to such deterioration as remained following an extensive program of repairs and improvement. The contrasting situation, of course, is found when repairs are neglected and the building is allowed to deteriorate and decay.

Church buildings illustrate a class in which the inherent element of economic obsolescence is lacking. A well-constructed church edifice, maintained in an excellent state of repair, cannot be depreciated by any rule applicable to schools, factories, apartments, hotels, or the like. Judgment must be brought to bear in every instance in computing depreciation, and average thumb rules must be modified by actual existing conditions based upon deterioration and utility.

in a premium saving. The requirements of the clause as to the amount of insurance necessary may result in a considerably increased total premium. The rate per thousand will be less, but because of the necessity of adding additional insurance the total charge may be more.

When the property is of such a type that 80 per cent or 90 per cent of the value seems considerably more than any probable loss, particularly when a substantial part of the value can be damaged by fire but slightly, if at all, exclusions may be made in the coverage. By the use of endorsements effecting such exclusions, the total value of the property insured may be substantially reduced, thereby reducing the amount of insurance made mandatory by the reduced rate contribution clause to avoid becoming a coinsurer.[2] Policies covering personal property in which there are ownership interests other than that of the insured may be endorsed to exclude the insured's interest. The following clause has been used to effect the exclusion:

> This policy does not cover the insured's interest in personal property in which parties other than the insured also have an insurable interest when the insured's interest in said property is otherwise covered.

Total Loss Risks. Many classes of unprotected property are almost certain to be a total loss, once a fire gets under way. This is to

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[2] Exclusions frequently made by endorsement on the policy follow:

1. Brick, stone, or concrete foundations, piers, or other supports which are below the under surface of the lowest basement floor, or, where there is no basement, which are below the surface of the ground.
2. Brick, stone, or concrete chimneys or stacks detached from building.
3. Piling for buildings or piling for wharf property not extending above low-water mark.
4. Cost of excavations.
5. Railroad tracks, underground flues, pipes, underground wiring and drains.
6. Contents of safes and vaults if specifically rated.
7. Water wheels, penstocks, and flumes.
8. Patterns, models, drawings, negatives, pictures, works of art; motion-picture films and machines and parts thereof.
9. Property mentioned in the printed conditions of the policy as excluded unless specifically mentioned as insured.
10. Property when stored in open yards, except when such property has been included under an average rate or credit in rate has been otherwise granted.
11. Dwelling contents (household furniture) may be excluded from blanket contents forms.
12. Personal property in which the interest of the insured is not that of entire ownership.
13. Pledged or secondhand articles.
14. Ingots—steel or iron.
15. Pig iron.
16. Coal, gas, and coke at gas works properties.

a degree true of certain classes of risk due to inherent hazards. Upon a property which will in all probability be totally destroyed, it is frequently deemed advisable for the insured to carry the maximum amount of insurance possible at the lowest rate. If the insured does not intend to carry full insurance to value, he may carry more insurance for the same premium with the coinsurance clause than he can carry without it. In the event of a partial loss he will be a coinsurer, but, feeling that any important loss will result in a total destruction of the property and the payment of the face value of the policies, he takes the risk of becoming a coinsurer in the small losses in favor of the additional insurance in a total loss.

Insurance agents who recognize the value of such a plan are extremely reluctant to advise an insured to adopt it. This is due to the fact that insureds who believe they understand the operation of the coinsurance clause frequently put the details out of mind. When the loss occurs and the companies point out that the insured must contribute to the loss, any misunderstanding gives rise to an embarrassing situation.

Coinsurance Deficiency Insurance. In some jurisdictions a form of coverage has been devised and made available which is designed to protect the insured against becoming a coinsurer because of fluctuating values at various locations covered under specific or blanket insurance. The deficiency coverage is limited to not more than 10 per cent of the total value of the merchandise insured.

The rate is that of the rate of the specific or blanket policies on the same risk. The policy can hardly be regarded as of importance. The risk it is designed to cover can be adequately cared for in a less complicated and a more satisfactory manner by means of blanket coverages and the pro rata distribution clause.

Guaranteed Amount Clause. Risks equipped with approved automatic sprinklers, and complying with inspection requirements and such other standards as the insurance exchange having jurisdiction may require, may use a special form containing provision for a guaranteed amount of insurance as an alternative to the 90 per cent reduced rate contribution clause. When such a permit is given, it is usual to require that the guaranteed amount be the full value of the property, and it is further required that a new statement of values be filed every year. Following is a form of the guaranteed amount clause:

In consideration of the reduced rate and (or) form under which this policy is written, it is expressly stipulated and made a condition of this contract that in the event of loss this Company shall be liable for no greater proportion thereof than the amount hereby insured bears to $.... nor for more than the proportion which this policy bears to the total insurance thereon.

The operation of this clause is identical with that of the reduced rate contribution clause, with the one exception that the amount of insurance to be carried is agreed upon in advance. Fluctuating values, therefore, will not penalize the insured, as is possible with the usual coinsurance clause if the insurance coverage is not adjusted to meet the changes in valuation.

Pro Rata Distribution Clause. The pro rata distribution clause is sometimes referred to as the "average clause." The clause is designed for use when it is desirable to insure two or more separate risks under a blanket form without the use of coinsurance. The clause is phrased in a number of ways. The following is typical:

It is a condition of this contract that the amount covered hereunder shall attach in or on each building, shed and other structure and/or place in that proportion of the amount hereby covered that the value of the property covered by this policy in or on each said building, shed and other structure and/or place shall bear to the value of all the property described herein.

The pro rata distribution clause, when used, has the effect of dividing the total coverage under a blanket policy to apply specifically upon each separate location, in the proportion that the value at each location bears to the sum of the values at all the locations. When no coinsurance clause is used under a blanket form, this clause is usually mandatory. The reason can readily be seen. If a man owned ten dwellings, located in widely separate locations, each valued at $10,000, a blanket policy covering all the dwellings for $10,000 would be full insurance in each location. Barring a catastrophe, the insured would be able to cover $100,000 in property values for the premium on a $10,000 policy. For this reason, exchanges offer the alternative of using the 90 per cent reduced rate contribution clause on such policies, or the pro rata distribution clause. When the first alternative is the one followed, in the instance of the ten houses just cited, the insured will be obligated to carry $90,000 insurance, unless he elects to become a coinsurer. If he chooses to write a blanket coverage with the pro rata distribution clause, whatever amount he carries will cover proportionately on each house. Thus, a $10,000 blanket policy with-

out the clause will cover on any house until the insurance is exhausted. With the clause, it will cover one-tenth on each house, or $1,000 only.

Use of Distribution Clause. There is little reason for the use of a blanket policy with the pro rata distribution clause in covering buildings. Their values can be determined easily, and they are not subject to sharp and sudden fluctuations in values. For this reason, specific insurance is more satisfactory.

In connection with coverage upon contents, however, the clause permits of a coverage that is a great convenience. Frequently the insured is the owner of stocks running to huge values that are constantly shifting from one location to another, but whose total value is more or less steady. When the subject of the insurance may, in the course of the insured's operations, be shifted from building to building, or when shipments are being made from time to time and incoming purchases received, it is not a simple matter to keep an accurate account of values in every location or to shift insurance coverages to follow changes in value. A blanket policy with the pro rata distribution clause automatically shifts the coverage as the relative values shift. It serves to provide an automatic coverage.

Advantages of the Clause. If adequate insurance to value is carried, the clause is far superior to specific insurance in a situation where an insured controls several locations with constantly shifting values. It can readily be seen that with specific insurance, a stock might be depleted in one location and increased in another. If the fire occurred where the inventory was high, particularly if the specific policies were written with coinsurance, the insured would be a heavy loser, even though his other locations were overinsured.

Again, the pro rata distribution clause without a coinsurance clause, as compared with the 90 per cent coinsurance blanket coverage, allows the insured greater leeway as to values, since he need not concern himself with the danger of becoming a coinsurer. On the other hand, however, when the 90 per cent coinsurance clause is used, the policies will pay a total loss in any location so long as the total insurance is equal to 90 per cent of the value insured. Under a policy with the pro rata distribution clause, in order to collect a total loss at any one location, the insurance to value must be 100 per cent.

Operation of the Clause. The pro rata distribution clause has the effect of making a blanket policy specific. It has the effect of

dividing the whole amount at risk to cover proportionately, in each specific location, an amount based upon the relative value of each location, to the total value of all locations.

For example, a manufacturing plant has five warehouses located in different parts of a city. As goods are completed, they are removed to one or the other of the warehouses to await shipment as orders come in. Shipments are constantly being made and stock is constantly added, and while values fluctuate in the different buildings, the aggregate remains reasonably constant.

If the total values in the four warehouses aggregate $50,000 and the total insurance carried is $30,000, blanket with the distribution clause, with inventories distributed as indicated below, the insurance would cover at each location as shown:

	Inventory	Proportion	Coverage
Warehouse A	$ 5,000	5/50	$ 3,000
Warehouse B	10,000	10/50	6,000
Warehouse C	15,000	15/50	9,000
Warehouse D	20,000	20/50	12,000
Totals	$50,000	50/50	$30,000

Now let us suppose that during the following month new goods as manufactured are added to Warehouse A, where there is the greatest amount of room, and shipments are made from Warehouse D. At the end of the month we have:

	Inventory	Proportion	Coverage
Warehouse A	$15,000	15/50	$ 9,000
Warehouse B	10,000	10/50	6,000
Warehouse C	15,000	15/50	9,000
Warehouse D	10,000	10/50	6,000
Totals	$50,000	50/50	$30,000

The point to emphasize in the foregoing examples is that the coverage automatically shifts with the inventory changes without any endorsement or change in the insurance policies.

If any warning is necessary in connection with the use of the clause, it concerns itself with the necessity for an adequate total amount of insurance to value. An insured with ten locations, with a $20,000 value at each, could not rely upon $50,000 as adequate to protect any loss, because one-tenth of $50,000 is all that would apply at any given location.

When the pro rata distribution clause is used in connection with

a coinsurance clause, the amount of insurance that covers on each location is allocated first, and then the procedure so far as the coinsurance clause is concerned is the same as if the insurance had been specific. It is apparent, however, that if the percentage of insurance to value required by the coinsurance clause is maintained as to total insurance to total values, there will be no difficulty in the specific application of the coverage.

The following apportionment illustrates inadequate insurance with the 80 per cent coinsurance clause:

Location	Inventory	Proportion	Coverage	Required for 80% Clause	Insurance Pays
Warehouse A.....	$ 20,000	20/100	$ 8,000	$16,000	1/2 loss
Warehouse B.....	30,000	30/100	12,000	24,000	1/2 loss
Warehouse C.....	50,000	50/100	20,000	40,000	1/2 loss
Totals.....	$100,000	100/100	$40,000	$80,000	

Three-fourths Value Clause. The effect of the three-fourths value clause is to limit the amount of the insurer's liability on a given property to three-fourths of the cash value of the property at the time of the loss or damage. The clause is used when it is deemed to the insurer's advantage that the insured assume a substantial share of the risk. Frequently premium concessions are made when the clause is used. In communities where there are few or no facilities for fire protection, and where a fire once started more often than not results in a total loss, it is believed that the clause serves to minimize carelessness. The following form is commonly used:

It is part of the consideration of this policy, and the basis upon which the rate of premium is fixed, that in the event of loss, this Company shall not be liable for an amount greater than three-fourths of the actual cash value of the property covered by this policy at the time of such loss, and in case of other insurance, whether policies are concurrent or not, then for only its pro rata proportion of such three-fourths value.

Total insurance permitted is hereby limited to three-fourths of the cash value of the property hereby covered and to be concurrent herewith.

If this policy be divided into two or more items, the foregoing conditions shall apply to each item separately.

If by reason of this clause the liability of the Company shall be less on such property than the amount of insurance thereon for which premium has been paid this Company will, on demand, refund to the insured for the full term of the policy the premium received by it on the difference between the amount insured and the amount paid for total loss on such property.

From the foregoing it will be noted that the clause is without effect upon the amount payable under the insurance policy, unless the damage is in excess of three-fourths of the value of the property. Thus, small partial losses are paid in full.

Three-fourths Loss Clause. A second clause, having much the same object as the three-fourths value clause, is the three-fourths loss clause. From the point of view of the insured the provisions of this clause are more stringent than those of the former. Instead of limiting the insurer's liability to three-fourths the value of the insured property, it limits the liability to three-fourths of any loss. Therefore, under the terms of this clause, whether the loss is large or small, the insured is obliged to bear one quarter of it. A copy of the three-fourths loss clause follows:

> It is understood and agreed to be a condition of this insurance, that, in the event of loss or damage under this policy, this company shall not be liable for an amount greater than three-fourths of such loss (not exceeding the sum insured) and, in the event of additional insurance permitted thereon, then this company shall not be liable for an amount greater than its proportion of three-fourths of such loss; in both events the other one-fourth to be borne by the assured.

The clause places a considerable burden upon the insured and has as a purpose the elimination of carelessness, as well as the action of a deterrent in the event that moral hazard may be involved.

Two-thirds Vacancy Clause. Some classes of property, when vacant or unoccupied, are considered to be more hazardous than others. This is particularly true of unprotected property, where tramps, marauders, or persons prompted by some malicious intent can break and enter. Insurers sometimes require as a condition of continuing the insurance upon the property while vacant, or unoccupied, or both, that a clause attach, suspending one-third the insurance during the period of vacancy or unoccupancy beyond the time permitted in the standard policy.

The clause is written in two forms. The first suspends one-third the insurance during the period of vacancy or unoccupancy. The second form, in addition to suspending one-third the insurance, also limits the amount payable under the insurance to two-thirds the amount of any loss or damage.

Depending upon circumstances, the clauses are written with the incorporation of other conditions. Sometimes it is required during

the period of vacancy that the doors and windows be adequately secured. Again, it may be required that the property be regularly visited by a person charged with general supervision, the purpose, of course, being to protect the property against breaking and entering by unauthorized persons and to eliminate, so far as possible, any element of neglect.

FOR REVIEW

1. The owner of a building of fire resistive construction contends that it is not economical for him to insure it with an 80 per cent coinsurance clause because he is less likely to suffer a total loss than is the case when the building insured is of frame or other inflammable construction. Is the reasoning correct?
2. A manufacturer stores his finished product in three warehouses so situated that they would probably not all be affected by a single fire. The total liability in any one location is limited to $50,000. The company therefore carries a blanket policy of $50,000, assuming that no loss will occur in excess of that amount. Wherein is the program unsound?
3. X owns a grocery store with a $50,000 stock. He started in a small way with a stock of $10,000. He carried $8,000 insurance with an 80 per cent coinsurance clause. As he made profits he continued to build up his stock, but since his indebtedness never exceeded $8,000 he limited his insurance to that amount. Assuming that the grocer may, if he wishes, allow his own stock to be at risk, what advice should he have with regard to the existing policy?
4. X owns a building valued at $100,000. A fire causes damage in the amount of $22,500. Adjusters, upon checking the policies, find two policies for $10,000 each written with a 90 per cent coinsurance clause, and five policies for $5,000 each written flat. For how much is each company liable?
5. X owns a building valued at $100,000. A fire causes damage in the amount of $22,500. Adjusters checking the policies find five policies for $5,000 each written flat. Two policies for $10,000, each written with a 90 per cent coinsurance clause, expired the day before the fire and were not renewed. Is the position of the insured better or worse because of the expiration of these policies?
6. In the yard of a manufacturing plant there are five warehouses. Stock in the warehouses is valued at $100,000. X, the vice-president, agrees that the stock be fully covered by insurance but insists upon a blanket policy written with a pro rata distribution clause. The treasurer contends that the policy should be written blanket with a 90 per cent coinsurance clause. You are asked to settle the dispute. What is your recommendation?
7. It is stated, as a general rule, that the insured is penalized in the case of a partial loss if his insurance is insufficient to meet the coinsurance requirements of the policy. Where is the dividing line above which, in the event

of a partial loss, the insured will no longer be penalized to the extent of becoming a coinsurer?

8. B operates a department store and carries insurance equal to 100 per cent of his values with an 80 per cent coinsurance clause. Is he permitted to do this, and if your advice were asked, what recommendation would you make concerning his coverage?
9. X completes a new building at the cost of $500,000. He sends for his insurance agent and, giving him the figures, asks for full protection. Y recommends $400,000 insurance with the 80 per cent coinsurance clause. His competitor, B, contends that he can supply the 80 per cent coinsurance coverage and save the insured 10 per cent or more of the annual premium. How can this be effected?
10. B owns a farm and in placing insurance is advised that his rate will be less if he has the policy endorsed with the three-fourths value clause. Advise the insured.
11. B carries insurance on the merchandise in the warehouse of his packing plant with an 80 per cent coinsurance clause. Every September his values drop $25,000 and are not built up until the first of the following December. B wishes to know how he may cancel $25,000 insurance every September without being penalized by a short-rate cancellation and at the same time have full insurance to meet his coinsurance requirements when values increase in December.

Chapter XVI

CONSEQUENTIAL LOSS

NATURE of Consequential Loss. In contrast to direct loss coverages, which apply to the physical loss or damage to the subject of the insurance, consequential loss coverages extend to provide indemnity for losses that accrue to the insured as a result of the hazards covered by the policy but flow as a consequence rather than involve an actual damage to the property, the subject of the insurance. For example, if a store is insured against loss or damage by fire, and an accidental fire in fact destroys the building and merchandise, such losses under the terms of a fire policy are direct losses. The fact that the owner of the store will lose profits because of the interruption of his business has the effect of establishing a consequential loss over and above the actual physical damage to building and merchandise. Again, the fire insurance policy does not cover profits on goods manufactured. Hence, if such goods are destroyed by fire before they are sold, this fact gives rise to a loss of potential profits. The loss of use of a property, or the loss of rental income from a property destroyed by fire, is not included in the direct loss policy. Consequential loss policies do not extend the fire policy as to hazards, but provide a different form of insurance against fire or other insurable hazards.

Temperature Damage. A considerable degree of uncertainty exists concerning losses due to temperature changes caused by the disruption of a heating or refrigerating system. When the temperature change follows a fire in the insured premises, there is reason to believe that the loss so occasioned is covered by the fire policy. When the stock is located in a building that secures its heat or refrigeration from a plant located some distance away, the uncertainty is intensified.

In risks such as cold storage warehouses, breweries, packing plants, greenhouses, ice cream factories, creameries, and others where there is a liability to loss or damage by interruption of power or change of temperature caused by the disablement of heating apparatus, the insurance company, without attempting to solve the problem, elim-

inates the question from the point of view of the insurer but not the insured by requiring the use of an exemption clause.

From this it does not follow that such losses are uninsurable. If the insured desires that his policy provide indemnity from losses of this type, he may eliminate the exemption clause and have attached a clause specifically assuming the risk. When the consequential loss and damage assumption clause is used, the 80 per cent or higher reduced rate contribution clause is required. If the heat or refrigeration is from apparatus outside the building containing the insured stock, and the rate on the building in which the apparatus is located or through which connections pass is higher than that on the building containing stock, an additional premium is charged.

When the risk receives its heat, power, or refrigeration from two or more separate units so located as to form separate fire risks, the stipulated additional premium may be reduced 50 per cent.

Garment Manufacturing. A similar problem is presented in the case of garments. When some parts of a garment are made at one location and other parts at another, or when garments are transferred from one location to another for different parts of the work, it can be seen that a fire in one location destroying parts of the garment might materially lessen the value of the undamaged parts at the other locations. To eliminate claims for loss, the following exemption clause is attached:

> This insurance does not cover any loss or damage due to the reduction in value of remaining parts of clothing or parts of suits resulting from the destruction of or damage by fire or by lightning to any other part or parts of such clothing or parts of suits unless such other part or parts of such clothing or parts of suits are in the same fire section.

If it is desired that the risk be assumed by the insurance, this can be accomplished through the payment of an additional premium and the endorsement of the policies with the necessary clauses, so as definitely to provide the coverage.

Profits and Commissions Insurance. Profits insurance indemnifies the insured for loss of profits on finished goods. When a manufacturer or wholesaler has substantial quantities of finished goods in storage, awaiting seasonal delivery, a fire destroying the goods would entail a substantial loss in anticipated profits, as well as the cost of the destroyed stock.

Profits insurance is written on two forms. The first limits the

liability of the company for loss of profits to the percentage of ascertained and adjusted property loss or damage. Under this form, if the direct loss on the stock is determined to be 30 per cent, the indemnity for the loss of profits under the profits policy is limited by the same percentage—that is, 30 per cent of the profits. The rate for this form is the published stock rate of the risk.

The second, or unlimited form, permits the insured to collect in full for the loss of profits on his stock, even though there is a property salvage and the property loss is settled on a percentage basis. The unlimited form furnishes the most satisfactory protection, for it is a recognized fact that even though the loss on a stock of merchandise is partial, the loss of profits may be far in excess of the percentage of direct loss. The rate for the unlimited form is twice that of the limited coverage.

Both forms are written with the coinsurance clause, and the usual reduction in rate is allowed. Likewise, the coverage may be extended to include such hazards as tornado, explosion, riot and civil commotion, explosion, earthquake, and other lines written by fire companies.

Commission insurance covers the commissions of selling agents. An agent or salesman might spend a season on the road taking orders for a future seasonal delivery. Orders for calendars and advertising novelties are taken the year around, but deliveries are made about December first. If a representative working on a commission basis were to have orders in for a year and the plant were destroyed before delivery of the goods, he might, depending upon his contract, suffer a substantial loss. The same insurance forms are used as for profits, and the same conditions prevail, with one exception. Under a profits policy, the goods under which a loss is claimed must be completed and ready for delivery. Under a commissions coverage, the goods need not have been completed, since it is sufficient to support a claim if the concern for which the goods were sold is unable to make deliveries because of a fire.

Business Interruption Indemnity. Business interruption indemnity protects against the loss of prospective earnings because of the interruption of business by fire or other hazards insured against, to the extent of the net profits prevented, plus such fixed charges and expenses as necessarily continue during the interruption, but only to the extent that such fixed charges and expenses would have been earned

had no interruption occurred. Business interruption indemnity, more widely known as "use and occupancy insurance," is to be distinguished from profits insurance in that profits insurance looks to the past, while business interruption indemnity looks to the future. Profits insurance, it has already been noted, protects the insured against the loss of potential net profits in finished stock in the hands of a manufacturer or any finished stock held in storage. In the event that this stock is damaged or destroyed, the direct loss insurance will cover only an amount necessary to repair or replace the damaged property. It will not cover potential profits. Hence, profits insurance is necessary for complete indemnity. Time is not a factor in determining the loss. In the case of use and occupancy, on the other hand, time is of the essence of the contract. Use and occupancy looks to the future and undertakes to protect the insured against loss of earnings as a result of the interruption of the business conducted in, or with, the physical property described in the policy.

The difference between the two forms of insurance is emphasized when it is realized that profits insurance on a mercantile stock will cover only the profit prevented on one turnover of the stock damaged or destroyed. For example, if a mercantile stock turns over ten times each year, it would mean that an interruption of six months in the business would result in a loss of five turnovers of the stock. Use and occupancy would cover this loss, but profits insurance would cover only the loss of profits on the inventory actually on hand and damaged at the time of the loss.

Losses occasioned by interruption to business during the rebuilding period after a property loss are often heavy and not infrequently of greater consequence than the loss occasioned by the destruction of the physical plant or material. When a fire makes it necessary for a business to discontinue operations, or to continue at less than the normal rate, use and occupancy insurance fills the breach and provides the business with uninterrupted income until the damage has been repaired, and normal operations have been resumed. During the period of interruption, the policy provides indemnity for net profits prevented and fixed charges and expenses that of necessity must go on during the suspension, to the extent that such profits and charges would have been earned but for the fire.

There is no fixed relationship between property damage loss or value and business interruption loss or value. The importance of

use and occupancy coverage becomes apparent when it is recognized that a small property loss in a vital section of the plant may cause a total suspension of operations, with a resulting loss far in excess of the actual property damage loss. On the other hand, it is conceivable that a very substantial property damage might occur without serious interruption of operations.

Use and Occupancy Value. In use and occupancy insurance the principle of indemnity operates as in other insurance coverages. A business establishment is operated for its earnings. The amount of insurance collectible under a use and occupancy contract is limited to the loss sustained through the interruption of the business because of fire or other hazard insured against.

Every going business at any given time finds itself in one of three situations; it is being operated at a profit, at cost, or at a loss. While business interruption indemnity aims primarily to indemnify the insured for loss of profits because of an enforced cessation or limitation of operations, it does not follow that an insured has no loss if the business is not making a profit. When a plant is shut down, certain fixed charges must go on if the business is to continue to function. The policy, therefore, not only covers loss of net profits on business prevented from being carried on, but includes also the payment of such fixed charges and expenses as must continue during the business interruption, to the extent that they would have been earned had there been no fire. Finally, the coverage makes allowance for expenses necessarily incurred for the purpose of reducing the loss.

It follows from the foregoing, then, that if a business is operating at a profit, and a fire causes suspension, the loss includes both the profit item and the fixed charge item, plus any costs incurred for minimizing the loss. If the business is operating at cost, and a fire occurs, the loss is the same, less the profit item. If the business is operating at a loss, it may still be earning part of its fixed charges, and to the extent that these are earned they represent a loss if business is suspended. The insurable value under a use and occupancy coverage, then, represents the profits for a year that would have been earned had there been no suspension or cessation of operations plus a year's fixed charges and expenses.[1]

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[1] The insurable value of a going concern may be estimated as follows:

1. Estimated business income from sales or service for 12 months following ..... $_____

Continuing Expense. In assuming liability for such fixed charges and expenses as must necessarily continue, the insured is faced with the necessity of segregating these charges to determine his insurable value. A study of the usual business establishment will reveal two types of continuing expenses: (1) full continuing, and (2) variable continuing. Thus, such items as salaries of officers and superintendents must be paid during a shutdown. Rent of undestroyed property, branch offices, distributing points, ground rents, and the like must be paid in full. Bond interest, interest on notes and other obligations, taxes, insurance premiums that must be continued, such as liability coverage, business life contracts, and insurance upon other property, all are fully continuing expenses.

In the category of variable continuing expenses the range is wider. Salaries of key employees, such as foremen and others necessary to keep the organization intact and ready to resume operations, must continue. The remainder of the pay roll may be discontinued. Part of the annual depreciation and maintenance charges should be classified as continuing, though the amount that could be figured in a loss would depend upon the property damage loss. Charges for electricity, telephone, and the like are variable; the minimum service of meter charges continuing. Noncancellable contracts, such as those for advertising, membership in trade associations, professional retainer fees, and the like, are to be included as continuing to the extent that they must be paid because of legal liability to do so or because they are necessary to maintain the business organization as a going concern. Fully continuing expenses offer but little difficulty in estimating use and occupancy values. To appraise the second group

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2. Discounts allowed ..... $_____
3. Allowances for returns, etc. ..... $_____
4. Charge-offs for bad accounts ..... $_____
5. Net cost of merchandise, or raw stock (whichever applies) ..... $_____
6. Total 2 through 5. Deduct from 1 ..... $_____
7. ESTIMATED GROSS EARNINGS ..... $_____
8. Salaries and wages that may be discontinued if operations cease ..... $_____
9. Water, power, fuel, etc. ..... $_____
10. Delivery service, light, heat, power, telephone, insurance and tax rebates, and other operating expenses that may be discontinued ..... $_____
11. Total of 8 through 10. Deduct from 7 ..... $_____

BALANCE represents use and occupancy insurable value ..... $_____

properly requires a careful analysis of the entire overhead expense of the business.

Forms of Coverage. Business interruption indemnity is written under five distinct forms. These are known as the per diem, per week, two-item coinsurance, gross earnings coinsurance, and specified time coinsurance forms. The coinsurance forms are sometimes referred to as "contribution forms."

The per diem and the per week forms are similar in their operation in that the liability of the insurer is based upon a daily limit or a weekly limit, whichever is named in the policy. Under the various coinsurance forms the limit is the face of the policy without regard to the units of time. To illustrate, under the per diem form, if a plant is operated weekdays throughout the year, 300 days is used as a basis for operations. Under a use and occupancy policy for $30,000, the company is liable for 1/300 of $30,000, or $100 indemnity for each business day of suspension. Thus a plant suspended for five weeks would be entitled to thirty days' indemnity, or $3,000. With the advent of the five day week, the per diem limit is computed as 1/250 of the total or face value of the policy. When operations are continuous, the per diem limit is 1/365. If the policy is written on a weekly basis, the limit is 1/52 of the policy face. When operations are seasonal, the per diem limit is found by dividing the sum of the yearly fixed charges and profits by the number of days of operation. Thus, a canning factory that operates 120 days, June through September, with annual earnings plus fixed charges of $60,000, would pay a daily indemnity for interruption during the indicated months of 1/120 of $60,000, or $500 per day.

Under the coinsurance forms the loss is paid without any per diem limitations, thereby taking care automatically of seasonal or daily fluctuations in earnings. The two-item form carries a coinsurance requirement of at least 80 per cent, based upon the annual gross earnings, less ordinary pay roll and expenses for heat, light, and power. In mercantile establishments where it is deemed desirable the ordinary pay roll (which is the total pay roll, less salaries of executives, officers, foremen, and others who would of necessity be retained during a period of shutdown) may be insured for a period of ninety days. Under the gross earnings forms, coinsurance clauses with a percentage as low as 50 may be written.

The form takes into consideration the prospective insurable

interest as one lump sum and pays the actual loss as it appears at the time of the fire. In the case of a department store, this would mean a high amount of indemnity for Saturdays, with lower amounts for the less active days, as well as higher sums for the periods of greatest activity, such as during the Christmas shopping season, and lesser sums for the dull periods between seasons. Likewise, department store operators contend that in order to keep their organizations intact during short periods of suspension, they must continue all or part of their force of employees and, for this reason, may wish to include in the coverage the item of ordinary pay roll. This increases the insurable value and with the operation of the coinsurance clause requires additional insurance.[2]

Constant Per Diem Form. Under this form the cover limits the daily payment to 1/300 of the face of the policy. If the number of days of operation differs from 300, then the fraction varies accordingly. When the annual earnings are $30,000, the period to rebuild is estimated to be two years, and the working time is 300 days per year, the per diem limit is 1/600 of $60,000. This form was for a long time considered suitable for a mercantile or manufacturing establishment with reasonably stable earnings and without sharp seasonal fluctuations. The per diem form is today being supplanted for most risks by the weekly form.

Constant Weekly Form. The constant weekly form is identical in principle with the constant daily form except that the limit of indemnity is computed on a weekly instead of a daily basis. This plan made its earliest appeal to mercantile establishments whose earnings for Monday tended to be light, but those for Friday and Saturday were increasingly heavy. Thus it was more equitable to compute use and occupancy values on a weekly basis. The form appealed to other classes of business enterprise, and today, in most jurisdictions,

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[2] Numerous forms have been devised to meet particular requirements, and while their provisions and conditions are in general the same, the most satisfactory coverage is to be obtained by using the form applicable to the risk. The forms most generally used are:

For manufacturing plants in steady operation—straight use and occupancy, per diem or weekly;

For mercantile or nonmanufacturing plants in steady operation—the 80 per cent (100 per cent) contribution form.

For manufacturing plants having seasonal operation or fluctuating earnings, and for mercantile or nonmanufacturing risks having seasonal operations or fluctuating earnings—fluctuating weekly form or contribution form.

the weekly form is the accepted method of coverage unless a coinsurance form is desired. Under the straight weekly form, recovery is limited for each weekly period of shutdown to 1/50 of the total insurance carried, except that, in some instances, notably if there is no interruption for Sundays or holidays, 1/52 of the insurance carried is the limit of the payment. The weekly form finds its appeal in the fact that it is less rigid than the per diem form for business establishments that habitually have varying days of business activity during the week.

Fluctuating Forms. So many types of business have earnings that fluctuate widely that a fluctuating coverage has been devised to meet their needs, written with the weekly or daily form. Department stores, for example, do a much greater business during the weeks just preceding the Christmas holidays than they do during the early part of the year. Again, heavier sales are usually made on Saturdays than on other weekdays. To meet the needs of such a business, the form permits the allocation of coverage to the periods on the basis of actual earning experience.

Coinsurance Form. This form of coverage makes no daily or weekly limitation of payment but requires coinsurance based upon the annual use and occupancy value of the business. This form has an advantage lacking in the others, in that it is the only one that automatically adjusts itself to fluctuating earnings. With 100 per cent coinsurance, the company is liable for any loss, whatever the amount, provided the face of the policy represents full insurance for the period of the policy.

When the two-item coinsurance form first made its appearance, 100 per cent coinsurance was required. While the older form is still used in some jurisdictions, a new 80 per cent form has been widely substituted. The 80 per cent form has an appeal in that it gives the insured some leeway in estimating his insurable value. With 100 per cent coinsurance, a slight fluctuation upward in insurable values has the effect of making the insured a coinsurer. In order to forestall this contingency, his only alternative requires the carrying of excess insurance to provide for such upward fluctuations, and this in turn involves an unnecessary expense. For this reason the 100 per cent form is all but obsolete.

The coinsurance form was used originally to insure department store and mercantile risks. It is, in fact, adaptable to any type of risk;

but in the case of department stores and risks of any other nature having earnings that fluctuate and which cannot be predetermined with any reasonable degree of accuracy as to the time or amounts of the fluctuations, no other form serves quite as well as the coinsurance form.

The coverage is divided into two items. The first item includes net profits and such charges and other expenses, as salaries for employees under contract, as must necessarily continue during total or partial suspension of business. This item covers expenses of necessary heat, light, or power, the cost of which is prevented from being earned during the time of total or partial suspension of business caused by fire, but does not cover any item of the insured's ordinary pay roll, which is covered in the second item. The second item covers on the insured's ordinary pay roll for a period not in excess of ninety days immediately following the loss or damage and covers only to the extent necessary to resume business operations. Unlike the per diem form, which grants a similar permission only by endorsement, this form allows the insured thirty days for stock replacement. If a longer period is needed, it can be granted by endorsement.

The second of the coinsurance forms, known as the gross earnings forms, provides indemnity for the ordinary pay roll. Under the two-item form, ordinary pay roll is included only when specifically insured and for a period of not less than ninety days. Competitive labor conditions, such as developed during wartime, brought into sharp focus the necessity of retaining employees of all categories to be available when the business reopens rather than relying on the recruiting of a new staff built around key employees. The gross earnings form requires that insurance shall equal 50, 60, 70 or 80 per cent of the difference between annual sales plus store rentals and the annual cost of merchandise. The lower coinsurance requirements give the insured a wide latitude in estimating his value.

Both coinsurance forms may be written in some jurisdictions with an agreed amount instead of a percentage of coinsurance if the insured files annually a statement of income and expenses with the rating bureau. The agreed-amount form has the advantage of eliminating the danger that the insured may become a coinsurer because of a deficiency in insurance, but it has the disadvantage that it requires the insured to file data that he sometimes is reluctant to make available.

Specified-time forms, with periods of indemnity as low as three months, have been written in a few territories. While they proved attractive in some instances, more recently, limited-term coverages have generally proved inadequate, and the short-term form is in but rare demand.[3]

Contingent Use and Occupancy. Use and occupancy protection is available to indemnify the insured in the event of loss due to damage or to the destruction of other plants furnishing material or parts to the plant of the insured. Likewise, coverage is obtainable which will insure against loss caused by damage to or destruction of other plants to which the product of the insured's plant is sold.

Expenses Incurred in Reducing Loss. In addition to providing indemnity to the insured for loss sustained because of the interruption of his business as a result of fire or other hazard insured against, the policy agrees to pay in addition such expenses as are necessarily incurred for the purpose of reducing the loss under the policy. This element is not computed in arriving at the use and occupancy insurable value, for as a matter of fact it adds nothing to the company's risk. The operation of this clause is illustrated by the following example. Assume that a seasonal business suffers a fire just as it is about to fill a number of large orders. The plant is insured for $1,000 a day, and work will probably be totally suspended for ninety days. As the insured does not wish his customers to go to another concern, he rents a neighboring property, sets up machinery, and is operating at full capacity in thirty days. Although the accomplishment of this feat involves working night and day shifts at increased labor costs, as well as other extraordinary expenses, and the total cost amounts to $20,000, the company considers it worth while since it is thereby able to keep its contact with valuable customers. The insurer is glad to pay $1,000 a day for thirty days, plus the $20,000 extraordinary expense, or a total of $50,000, instead of the $90,000 it would have to pay if the plant remained closed for ninety days. If the insured for the same reason had taken the same steps at an expense of $70,000,

[3] The new use and occupancy forms limit liability to a period of 12 months from the date of the loss. This is so, even in partial losses where the face amount of the insurance is not exhausted. If the business is of such a nature that there is a possibility that the property may not be restored in a period of 12 months, then a policy should be written for a longer period. It may be necessary for full protection to write a policy for 18 or 24 months or even longer. Under the coinsurance form, policies are ordinarily increased with reference to periods of time in multiples of 3 months.

with a shutdown of thirty days instead of ninety, the insurer would be liable, not for $30,000 plus $70,000, or $100,000, but only for the limit of $1,000 a day for ninety days. In other words, since nothing has occurred to reduce the insurer's obligation, it remains unchanged. When, however, the obligation is reduced, costs incurred in effecting this reduction are covered.

Extra-Expense Insurance. Extra-expense insurance covers the expense of doing business in a location, other than the usual premises of the insured, if the move is necessitated by a hazard covered by the insurance policy. It is sometimes confused with use and occupancy insurance, but when it is recalled that use and occupancy insurance covers loss against interruption of the business and extra-expense insurance covers the additional cost of carrying on a business following a loss, the difference in the two forms of insurance is at once apparent. The insurance is sometimes referred to as "additional charges and expense insurance" or "surplus charges and expense insurance." The tendency is developing to use the shorter form, "extra-expense insurance."

The need for this type of coverage evidences itself when the business activity cannot well be allowed to stop even in the face of a fire or other type of loss. A newspaper forms an admirable example. Rarely will a newspaper cease publication. It may be necessary to hire the presses of a competitor or even to go to a distant community to have the paper issued on schedule. Transportation charges, communication services, additional cost of composition and presswork—all tend to build up costs far in excess of those normal to the insured in his own plant. The use and occupancy policy provides indemnity for the interruption of the insured's business. The extra expense contract provides for the additional cost of doing business in a temporary location pending re-establishment of the business after the damaged property has been restored.

There is a form of extra-expense coverage known as the "additional living expense form," available for residents of dwellings and written in connection with rental value insurance. Rental value indemnifies the insured for the rental value of the home during the period it is unfit for occupancy because of a loss caused by a peril covered by the insurance. The additional living expense form reimburses the insured for excess expenses necessitated by securing temporary living quarters during the period the property is not habitable.

Insurable Hazards. In addition to losses caused by business interruption due to fire, use and occupancy insurance is written in connection with numerous other hazards. Among the hazards more commonly insured are windstorm, explosion, riot and civil commotion, sprinkler leakage, water damage, steam boiler explosion, and machinery breakdown. The forms used in connection with the fire hazard may be applied to the additional hazards mentioned, and in principle the coverage is essentially the same.

Contract Insurance. When a manufacturing concern has effected a particularly advantageous contract for the supply of raw material, or parts, and has based its production schedule and sales prices upon the continuation of this supply, the possible interruption of the supply is a very real hazard. A fire destroying the plant of the concern supplying the parts or the raw material might not cause an actual shutdown on the part of the manufacturer, but it might oblige him at an inopportune time to go into the market and effect a new contract upon much less favorable terms.

The risk is insurable under a contract form. The insurer agrees to indemnify the insured for loss occasioned by a failure of the supply concern to comply with the conditions of its agreement if the cause of the failure is a fire on its own premises. The measure of damage is the difference between the cost to the insured of the material contracted for, bought on the best terms possible, and the price for which he was getting it before deliveries were interrupted by the fire. Costs include transportation to the insured's plant. The coverage is not a common one, and the risk is more often covered to the satisfaction of the insured by contingent use and occupancy.

Tuition Fees Insurance. Private schools, run for profit, are dependent upon the income derived from tuition fees for their maintenance. A fire that destroys any substantial part of the property of the school might necessitate a temporary suspension of operations, with a consequent obligation to refund tuition collected or to cancel charges already made. Nor is there any assurance, with the work of reconstruction and repair completed, that all the students formerly enrolled will return. Thus, the consequences of the fire from this angle alone may be far-reaching enough to disorganize the entire program of the school.

The insurance, as written, indemnifies the insured for loss occasioned by the necessity to return, or the failure to receive, tuition

fees as the outgrowth of a fire. If the fire occurs during a summer vacation, the loss is computed on the basis of the attendance for the previous year. The policy pays for the loss of tuition fees sustained after the expiration of the policy if the fire occasioning the loss occurred during the policy term. It is usual to require the 100 per cent coinsurance clause, and the rate charged is the 80 per cent building rate. The form is a specialized type of business interruption indemnity designed for a particular class of business.

Unearned Premium Insurance. The fact that the face of a fire insurance policy is reduced by the amount of the loss, regardless of the term for which the policy is written, is regarded as an unfavorable factor of term insurance. When a premium for one year is $10, the five-year premium would be $40. Yet a fire the first month of the first year that caused a total loss would exhaust the policy, and the $30 paid for the three succeeding years would be lost. In small premiums the question is not often considered, but when the sum involved is many thousands of dollars, the risk involved is of greater concern.

A summer hotel property with an annual premium of $15,000 could be insured for a five-year term for $60,000. Yet should a total loss fire occur in the first year of the five-year period, $45,000 of the $60,000 advanced will be lost. If the policy is purchased on an annual basis, this eventuality would not occur.

The unearned premium insurance protects the risk thus created. The forms, as written, either add to the amount collectible under the fire contract covering direct damage as much of the premium as would be unearned if the policies were canceled pro rata without a loss at the time of the fire, or restore the policies covering the property to their original amount. In either case, there is no loss to the insured as a result of the reduction or cancellation of the policies because of the payment of a loss.

Since the hazards affecting the risk are those that attach to the insured property, the same rate applies to the unearned premium risk. Since, however, the amount collectible is reduced day by day, the premium charge is based upon the average liability during the policy term.

In a strict sense, the term, "unearned premium insurance," is hardly correct. What the policy, in fact, undertakes to do is to return to the insured as much of the premium as would be necessary to carry the policy for the unexpired term from the time of a total loss

to the expiration date of the policy. Presumably, because of the tendency to refer to a premium due the insured on the cancellation of a policy as an unearned premium, this form of insurance has been termed "unearned premium insurance." If the policy is terminated because of the payment of its face, legally there is no unearned premium, since under the terms of the contract the full prepaid premium is earned. For this reason the name of the contract has been subject to some criticism.

Rents and Rental Value Insurance. If a property is rendered untenantable by fire, in addition to the direct loss or damage, there is a loss of use if occupied by the owner, or a loss of rental income if occupied by a tenant. Losses from this source are insurable under a rents or rental value form.

Rents insurance indemnifies the owner of a property in the event that his rental income is cut off or interrupted by fire or other hazard included in the coverage. Rental value insurance covers the occupant and indemnifies him for the loss of use of the premises. The occupant may be the owner, in which case his indemnity represents the rental he must pay to secure premises similar to those destroyed or damaged. On the other hand, if the occupant is a tenant under a lease so drawn that his payments must continue during the untenantable period, he too is indemnified on the same basis as if he were the owner.

Rents insurance is a particularly important coverage for estates whose holdings are largely real estate, the beneficiaries of which would be seriously inconvenienced if their income should be interrupted for any lengthy period. Trustees might be willing to carry the risk personally on their own property but are frequently unwilling to take the risk as trustees if the beneficiaries of the trust depend largely upon the income from the real estate in question.

Rental forms in common use require full insurance to value. When the insurance is less than the full rental value for the period covered, the insured becomes a coinsurer to the extent of the deficiency. For example, a building having a rental value of $48,000 annually is insured for $24,000. It is rendered untenantable for one month at a loss of $4,000. Since coverage is only 50 per cent of value, the insurance pays $2,000. To be fully protected, the insured must carry a policy of $48,000.

If the form is based upon the rental value for the length of time

required to rebuild the property if totally destroyed, the amount of insurance necessary for full coverage is the amount of income received during the estimated period. The form, as in the previous case, contains the 100 per cent coinsurance clause. The period estimated as the time required to rebuild should be generous; otherwise, when a loss occurs, the insurance may be found to be inadequate.

In seasonal risks, the months of customary occupancy are incorporated into the form, and the policy is written to limit its liability for loss of rental value only during this period. A summer home, with a rental value of $1,500 for the months of June, July, and August, would be insured for $1,500 for one year under a seasonal form. If damaged in September and repairs could reasonably be completed before the following June, there would be no liability under the policy. Damage in May that could not be repaired until September would require the payment of the face of the policy. When a property is untenantable for a month or fraction thereof during the indicated usual period of occupancy, indemnity is paid on a pro rata basis, that is, at the rate of $500 for each month so vacant.

The period for which a loss may be collected begins with the happening of the fire, or other contingency insured against, and runs for the period required with the exercise of reasonable diligence to restore the property. The loss must originate during the term of the policy, though the liability may continue beyond its termination.

Leasehold Insurance. If a business location is held under the terms of a lease, it is possible that any advantage accruing to the lessee may be wiped out by a fire in the premises. Leases are drawn with a view to meeting a situation brought about by a fire. The lessor may be willing to accept a given rental for his building, but if required to rebuild it after a fire he might be obliged to ask a considerably higher rental. To this end, a clause is incorporated in the agreement giving one or both parties the option to cancel and terminate the lease if the property is damaged to an agreed extent by fire. This is termed the "fire clause."

Tenants possessing long-term leases frequently find that because of changing conditions their location has materially increased in rental value. In other cases, merchants, desirous of securing a favorable location, have paid a substantial bonus to secure a lease held by another. In the first instance, the increase in value of the leasehold

represents an insurable interest. Likewise, in the second case, the bonus represents an investment that is as insurable as if the same amount of money had been expended on the improvement of the building itself. In either case, if the building were destroyed by fire and the lease subsequently canceled by the lessor, the lessee's interest would be a total loss.

Again, a source of loss is to be found when premises held on a long lease are sublet at higher rental. A fire resulting in a cancellation of the lease by the owner means a loss on the part of the lessee equal to the difference between the rent he pays and that which he receives from the tenants to whom he has sublet.

The leasehold interest policy does not cover losses growing out of the loss of use of the building, such as loss of potential profits, goodwill, or other types of consequential loss. It limits its coverage strictly to the loss occasioned by the cancellation of a lease when the rental value is in excess of the rent payable. It does extend to indemnify the insured, when the lease is not canceled, but when during a period of temporary repairs he is obliged to seek a new location and pay a higher rent therefor than he pays at the damaged premises. It does not cover in the event of the cancellation of the lease for any reason other than damage by fire, tornado, explosion, earthquake, water damage, or other specific hazard designated as covered by the insurance. If the loss is occasioned by any act of the insured, or if the lease is terminated by the insured's exercising an option to cancel, there is no coverage under the policy.

In writing a leasehold interest policy, the fire clause in the lease furnishes the key to the entire underwriting problem. When the clause is vaguely stated and gives one or both parties the right to terminate the lease in the event of a fire, a leasehold interest under such an agreement is uninsurable. A satisfactory form of fire clause will require that the property be over 50 per cent destroyed by fire before the lease may be canceled. Discounts from the rate are sometimes allowed if the fire clause requires a 75 per cent or more destruction before the right of cancellation arises. From the point of view of the underwriter, the higher the percentage indicated, the more favorable the risk. If no fire clause appears in the lease, statutes in the state where the property is located govern in case of fire. When the statute is considered adequate from the insurer's viewpoint, a leasehold

interest policy may be written, incorporating into the form the stipulation that the statute of the state is to be followed in the matter of right to cancel.

Rates for leasehold interest are governed by the building rate. Since a leasehold interest reduces in value from month to month as the term of the lease runs toward expiration, with no value left at expiration, it will be seen, if one follows the idea of indemnity, that regardless of the amount written in the face of the policy the amount collectible is less each month. For this reason the form itself provides for this continued reduction in the amount payable, decreasing the amount as the policy approaches expiration. The premium, so that it may be equitable, is based upon an average of the amount the insurer has at risk during the policy term. The average is found by adding the insurable value at the beginning of the policy term to the insurable value at its termination and dividing by two the sum so found. The average thus obtained is multiplied by the rate, and the resulting amount is the premium for the policy term. The face amount of the policy is the value of the lease the day the policy is written.

When substantial amounts are involved, the element of discounting becomes a most important factor in the calculations. Assume, for example, that a lessee 10 years ago secured a lease of a property for a rental of $1,000 a month for a term of 20 years. At the present time, he finds that he would be obliged to pay $2,000 a month for the same or similar property. The net value to the lessee of his leasehold interest, then, is $1,000 a month. Since the lease has 10 years, or 120 months, to run, the lessee stands to lose $1,000 a month for 120 months if his lease is canceled. The insurable value of the leasehold interest, however, is not $120,000, as might at first sight be presumed. Taking into consideration the element of interest, the sum of $120,000 in cash is worth a substantial amount more than is $1,000 a month for 120 months. To arrive at the net leasehold interest in this situation, the present value of $120,000, payable at the rate of $1,000 a month, must be calculated. This can be accomplished by means of a mathematical calculation. For convenience, a table has been computed showing the amount which, compounded annually at a given rate of interest, will increase to a dollar in a given number of months. It also shows the amount for which a policy should be written for each dollar of monthly insurable interest for the number of months a lease has to

run. In our example, the insurable value of $1.00 a month for 120 months is found and multiplied by 1,000 to find the present cash value of the leasehold interest. To find the amount of loss payable under the policy, the present value of the insurable monthly interest is computed as of the date of the fire, and the sum so found is payable in a lump sum to the insured. The amount in dollars and cents will vary substantially with the interest rate used in the computation of the table used. Published interest tables may be used in making the computations, though special tables for the purpose are usually made available by companies writing the coverage.

Leasehold interest policies may be written on an annual basis or for a term, as may the fire policy covering the direct loss. Upon renewal, or at any time during the policy term, if a change in the leasehold value takes place, the insurance may be adjusted to cover accordingly. A leasehold interest may run to great value, and executors or trustees particularly should recognize their obligation to protect and preserve this value as an asset, just as they would protect an asset represented by ownership of physical property. This value, however, is frequently overlooked.

Excess Rental Value. A converse of the leasehold interest contract is found in the excess rental value policy which undertakes to protect the owner of buildings who has an advantageous lease which, if canceled, could not be renewed on equally favorable terms. This is in contrast to the leasehold interest policy, which provides indemnity if the lessee is obliged to cancel a lease that is worth more than the price he is paying.

The excess rental value policy operates in the following manner. Assume a lease written ten years ago for a period of twenty years and calling for a monthly payment of $2,500. Assume further that on the present market the most the property would bring is $1,500. Under these circumstances, the property owner has an insurable excess rental value in the lease of $1,000 a month for ten years. If the property should be so destroyed by fire that the lessee could elect to cancel, it is at once apparent that this would be the logical procedure for him to follow. In these circumstances, if the owner of the property restored it and offered it for rent, his income would be reduced by $1,000 a month. As in the case of leasehold interest, the insurable value is determined by discounting the monthly payments and finding their present lump sum value.

FOR REVIEW

1. May the profits policy carry a coinsurance clause? If so, to what is the coinsurance percentage applied to determine the amount of insurance necessary in order to be fully reimbursed in the event of loss?
2. B is the president of a company engaged in a manufacture of an article enjoying a seasonal sale. He recommends to his board of directors that the anticipated profits to be derived from goods stored in a warehouse be covered by insurance. One of the directors objects to the purchase of the policy on the ground that in the case of a partial loss the profits policy pays a profits loss in proportion to the direct damage loss. He feels that all profits are wiped out if goods are partially destroyed. What is your answer to this objection?
3. B is the trustee of an estate whose beneficiaries are dependent for their income primarily from the rent of a small-business block. How may the trustee assure the beneficiaries a continued income even though the buildings be destroyed?
4. The owner of a business property secures a rental value policy which undertakes to pay the rental value to the insured, whether or not the damaged property is fully rented at the time of the fire. The property is rented in its entirety under lease to a responsible public utility firm. What is your recommendation with reference to this leasehold coverage?
5. B owns a summer hotel upon which he pays an annual insurance premium of $20,000. His agent suggests writing the business on a five-year basis paying four annual premiums, thereby saving one full year's premium less interest. The insured contends that he cannot afford to advance $60,000—that by so doing he places the additional amount at risk. This is so because, should the property be totally destroyed during the first year of the policy, the $60,000 additional premium would be lost. What should the agent recommend?
6. X, the president of B company, in adjusting a use and occupancy loss, contends that he is covered under a per diem form for $200 a day and therefore insists this to be the company's liability. As a company adjuster, what would be your answer?
7. The B manufacturing company has automatically renewed its use and occupancy policy without change for several years. For the last three years the concern has been losing money. What is your recommendation to the insured?
8. What are the particular features that make the coinsurance use and occupancy form attractive to certain types of business organizations?
9. A manufacturing plant is made up of five separate units, each in charge of a vice-president. You are asked to make an insurance survey and, upon examination of the policies, discover that each unit carries an adequate use and occupancy coverage. What recommendation would you make and why?
10. Is use and occupancy coverage limited to the fire risk, or may it be extended to include other hazards?

11. X is the manufacturer of straw hats. Before the summer season his plant burns, and the entire stock is destroyed. The insured claims that the goods burned could not be immediately replaced at the scene of the fire with goods of like kind and quality. He therefore claims the wholesale market price for the goods rather than the manufacturing costs. Can he collect?
12. B owns a camp in which he uses an oilstove for cooking purposes. While left unattended, the flame in the stove creeps unusually high and saturates the building with smoke. Will the fire policies be liable?
13. X has $5,000 worth of cereals stored in a warehouse. There is no fire in the building but a fire a block away fills part of the building with smoke. The cereals are damaged since they have absorbed the odor. Is this a fire loss?
14. A stock of goods stored in a warehouse is extremely susceptible to moisture. Will the fire policies on the stock cover a moisture loss if there is no fire whatsoever in the premises, but the stock absorbs moisture because of the putting of water on a fire in neighboring premises?
15. X carries a profits insurance policy with an 80 per cent coinsurance clause. How is this clause interpreted with reference to profits?
16. A manufacturer of Christmas toys has a loss by fire, destroying his entire stock just before the shipping season and too late to replace them to fill orders for the current season. To hold his customers, he wishes to go into the open market and purchase the goods to fill orders. Will his fire insurance reimburse him for the full cost of the goods?
17. The C. D. E. Manufacturing Company is operating at a loss and, therefore, sends its use and occupancy policy for cancellation on the ground that there will be no interruption of profits in the event the plant is shut down. Is the reasoning correct?
18. A department store asks whether a fluctuating per diem form, or the coinsurance form of use and occupancy, best meets its needs in view of the fact that in certain seasons the profits are high and in others very low. What is your opinion?
19. The A. B. C. Company has a use and occupancy insurable value of $100,000. This includes annual net profits and expenses. The company carries a use and occupancy policy for $80,000 on the coinsurance form. During the month of February, as a result of fire, the store is closed for twenty business days. It is during a period of slack business, and the loss amounts to $200 per day. How is the loss computed?
20. The plant of a manufacturing company is divided into several units. Each unit completes a part of a process, and the finished product is assembled in one unit of the organization. Use and occupancy insurance is carried on each unit. Is this permissible or desirable?
21. The X manufacturing company carries a use and occupancy policy written on a per diem form. Business is interrupted for seventeen days as a result of fire damage to the plant. There is a further interruption of ten days required to replace raw materials. The insured files a claim for twenty-seven days' loss. Is this loss collectible?
22. Fire insurance policies written to cover merchandise in packing houses,

cold storage warehouses, markets, and other like institutions, unless specifically endorsed to anticipate the risk of damage by temperature change, may leave the insured in an uncertain position in the event that fire disables the refrigerating apparatus. How is this problem met?

23. B has a use and occupancy policy covering on his plant. He claims that, in case of loss covered by the policy, funds will be forthcoming from the insurance to: (*a*) Maintain the soundness of his company's financial condition by paying profits lost through cessation of production. (*b*) Continue his regular advertising program. (*c*) Keep his organization intact. Any successful business has a well-trained organization of senior and junior executives, department heads, sales department and sales force, and operating personnel. A large percentage of these people, through years of training and experience, have become highly essential. The loss of these people to competitors because of inability to keep them on the pay roll would be disastrous. (*d*) Pay dividends to stockholders. A stockholder has the right to assume that his income will not be adversely affected by an interruption of earnings of the business as a result of loss caused by an insurable peril. (*e*) Pay federal, state and local taxes. (*f*) Pay interest on bonded indebtedness. (*g*) Pay for legal and other professional services. (*h*) Pay extra costs involved in resuming operation of the business at the earliest possible moment. (*i*) Pay the many unavoidable expenses that continue during a shutdown. Which of the foregoing will the insurance pay?

24. It is of course obvious that consequential losses can be serious. It is a natural tendency for owners of property to insure the physical property and neglect intangibles. Discuss impact of failure to insure consequential risks.

CHAPTER XVII

SPECIAL AND ALLIED FIRE LINES

FALL of Building. The provision found in the older standard forms terminating coverage in the event of the collapse of the building insured made additional insurance coverages necessary to provide adequate protection to the insured property from fire and other hazards. The clause reads: "If a building, or any material part thereof, fall except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease." This clause does not appear in the New York form of 1943. It is of interest, therefore, only in those states where one of the older forms is still followed. Allied fire lines are written in the various states to coordinate the coverages with the standard fire policy in use. Because many business institutions operate on a nationwide basis, it is important to note the effect of the "fall of building" clause, even though it does not appear in the policies of most states.

This clause has been interpreted by the courts to mean that the insurer is no longer liable for damage by fire if the entire structure or if a substantial part thereof falls, leaving the remainder impaired as to usefulness and as a functioning structure. The cause of the fall must be some force other than fire; otherwise, the fire policy is liable for the damage. Such a force as might cause a building to fall and void the policy would be the withdrawal of support by digging, a windstorm, or an earthquake. To have the effect of canceling the policy, the subject of the insurance must cease to be a building.

A study of cases fails to elicit a clear-cut answer as to what constitutes "fall of the building" within the meaning of the policy. As near as a general rule can be formulated, it may be stated that the insurer is excused from its obligation by the fall of the building either as a structure or such a substantial and important part thereof as impairs its usefulness.[1] To come within the meaning of the clause, the structure in question must cease to be a building, to be fallen within the meaning of the policy. So long as the building is standing, how-

[1] *Nelson et al.* v. *Traders' Ins. Co.*, 74 N.E. 421; 34 Ins.L.J. 933.

ever dilapidated and depreciated it may be, the policy covers.[2] The courts apparently interpret the clause to apply to the fall of a building caused by inherent defects or by the withdrawal of necessary support, as in the case of undermining. Collapse caused by storm, flood, or earthquake would cause the clause to operate.[3] On the other hand, when the building falls as a result of explosion, and fire follows, the fire insurance policy does not cover the explosion damage but does cover the ensuing fire damage. This apparent exception to the "fall of building" clause is not, in fact, an exception but is the subject of a separate clause in the policy.[4] While it may seem that the two clauses are contradictory, the courts have clearly indicated that if the building shall collapse as a result of explosion, the policy continues to cover the ensuing fire damage but will not cover the explosion damage. In the case of collapse of a building from causes other than explosion, it has been held, on the one hand, that the building need not necessarily be a mass of ruin to terminate the coverage but, on the other hand, that the damage must be sufficient to affect seriously the functional use of the building.

Bridging the Gap. The principal causes of building collapse are windstorm and earthquake. If a building insured under a fire policy is damaged to a degree that voids the fire coverage under the "fall of building" clause, to be adequately protected the insured will require a policy that will pick up the liability at exactly the point where the other terminates. This feature of providing a continuity of coverage is termed, "bridging the gap." Because of the fire coverage that windstorm and earthquake policies must assume, it is obvious that regardless of the damage the wind or the earthquake may do before fire ensues, coverage to be adequate should equal in amount the insurance necessary for proper fire protection.

Windstorm Insurance. This coverage has for its purpose the indemnification of the insured for loss or damage directly caused by windstorm of any nature. This includes fire damage caused by the windstorm if the damage has been of a nature to void the existing fire policies. The policy was originally termed a "tornado policy," but as now written the storm need be of no particular degree

[2] *Firemen's Ins. Co.* v. *Sholom,* 80 Ill. 558. Other cases bearing upon the interpretation of the clause are: *Fountain* v. *Connecticut Fire Ins. Co.,* 112 Pac. 546; *Claburg* v. *Agricultural Ins. Co.,* 102 Pac. 812.

[3] *Leonard* v. *Orient Ins. Co.,* 127 Mass. 346.

[4] See "old" New York standard form, line 34, and "new" New York form, lines 59–61.

of severity or type to bring the damage within the scope of the coverage.

The windstorm policy does not cover loss or damage caused by hail. If, however, the wind itself has caused an opening in the building insured and hail enters and causes damage, the loss is occasioned by the opening and not directly by the hail. Because of misunderstandings growing out of claims for hail damage, some territories have made hail coverage mandatory and have adjusted the rate accordingly. In other territories, losses caused by hail may be included in the coverage by endorsement, upon the payment of an additional premium. The policy likewise excludes from coverage losses occasioned by frost or cold weather, whether incidental to a windstorm or not, as well as losses caused by cloudburst, explosion, or lightning. Nor are losses covered that are caused directly or indirectly by tidal wave, high water, or overflow, whether driven by wind or not. Unless specially incorporated in the coverage by endorsement, there is no liability for losses to: metal smokestacks; awnings; signs; fences; lumber; radio towers; sculpture; silos; windmills; water towers; tanks; standpipes; telegraph, telephone and electric wires; temporary board-roofed additions; or temporary board-roofed structures.

From the point of view of the insurance company, certain types of risk are considered undesirable and are either not accepted for insurance at all or are accepted only after careful investigation of the particular risk and all the hazards involved. In the classification of undesirable risks are: brickyards; buildings under construction, unless fully enclosed; buildings with board, thatched, hay or straw roofs; buildings that are frail or dilapidated; fairgrounds; greenhouses; growing or stacked crops; lumber yards; sheds; trees; wind pumps; and wind powers.

In the case of plate, leaded, stained, or cathedral glass, coverage is excluded when specific insurance is provided. When such glass is not specifically insured, loss under the windstorm policy is limited to that proportion of the insurance carried that the glass bears to the total value of the building. Thus, when the value of plate glass represents one-twentieth of the building, only one-twentieth of the insurance carried would apply to glass. When the amount of insurance to apply to glass is determined, it is further distributed by providing that the proportion of the insurance ascertained to apply on glass shall apply to each plate of glass covered in the proportion

that the value of each plate of glass bears to the total value of all such glass. To cover plate glass fully, therefore, 100 per cent of insurance to value of the entire property is necessary. Ordinary glass does not come within this limitation.

Windstorm policies are written on the standard form of the Tornado Insurance Association. The policy may be written for one year or longer, with the same premium credits as are allowed in the case of fire policies written for a term. The practice is to write the coverage with a 50 per cent coinsurance clause, and this or a higher coinsurance clause is customary. When, however, the insured elects to use a coinsurance clause higher than 50 per cent, deductions from the 50 per cent rate are allowed. The coverage may be extended to include leasehold interest, profits, commissions, rents, use and occupancy, and a blanket mortgagee's interest.

Earthquake Insurance. The purpose of the coverage is to indemnify the insured for loss or damage sustained as the result of an earthquake or volcanic eruption. As in the case of the windstorm coverage, the policy covers loss or damage by fire when fire ensues, and the fire policy is voided as a result of the earthquake. Ordinarily the company writing earthquake insurance requires a portion of the fire line. The most desirable coverage gives all companies writing the fire coverage an identical amount of earthquake coverage. In such a coverage, there is no inequitable result if there is any uncertainty as to whether the loss is a fire loss or an earthquake loss. In either case, the same companies pay.

Like the windstorm policy, earthquake coverage may be written for a year or a term; likewise, such supplemental coverages as rents, rental value, leasehold interest, use and occupancy, profits and commissions may be written. Again, as in the windstorm coverage, the 50 per cent or higher coinsurance clause is usual except in the case of dwellings, but when a higher than the 50 per cent clause is used corresponding deductions from the 50 per cent rate are allowed.

For the purpose of rating, the country is divided into zones. Special rules and rates are promulgated for the Pacific coast because of the conditions peculiar to that area. Building types, depending upon material, construction, and the like, are divided for the purpose of rating into different classes. Rates depend upon the location and construction of the building.

Aircraft and Motor Vehicle Property Damage. With the con-

tinued development of aviation, the risk of damage to property caused by falling aircraft increases. The risk is insurable under the aircraft and motor vehicle property damage policy, which provides indemnity to the insured for loss or damage caused to his property from falling aircraft, regardless of the type, including loss caused by objects of any kind falling from the aircraft.[5] Damage caused by automobiles or other motor vehicles is likewise insured. The coverage includes, in addition to buildings and contents, loss to lawns, trees, shrubbery, and other landscape features.

This policy, like the windstorm and earthquake coverages, contains a "bridging the gap" feature in that if, as the result of a motor or falling aircraft damage, the building falls, with the result that the fire policies are voided, this policy picks up the liability and covers the ensuing fire damage, if any.

That there is a considerable risk from falling objects is now recognized. Buildings have been badly damaged by an airplane crash and totally destroyed by the ensuing fire. A country club golf course might be chosen for a forced landing, with a degree of damage depending upon the success of the effort. Dripping oil, falling tools, discarded ballast, and the like are causes of loss. The possibilities of damage from the crack-up of a huge plane are limited only by the value of the property in question.

In addition to rents and rental value, use and occupancy, profits and commissions, floater policies are written to cover race horses, polo ponies, equipment of various types, or property whose value and location are changing. Special policies have also been written to cover growing crops in the field.

[5] The crash of an Army plane in May of 1946, against the seventy-one story Bank of Manhattan Co. Building in Wall Street, New York, resulted in the payment of the first insurance claim in the United States for direct and physical damage resulting from aircraft to a skyscraper. The insurance was placed following a like crash to the Empire State Building the previous July. The Empire State Building Corporation made a claim to the Army adjusters for $487,352.44. The claim was ultimately settled for $288,901.90 and Congress passed an appropriation for this amount. This was the largest of a number of claims the outgrowth of this accident.

Damage to the Bank of Manhattan Co. Building was estimated at approximately $50,000. Other heavy aircraft damage losses have occurred. A three-alarm fire was started, and thirty-two people were killed when a four-engine bomber crashed into a five-story meat packing plant in Seattle, Washington, February 18, 1943. A plane crashing into a hangar at Wright Field, Dayton, Ohio, March 5, 1945, caused eight deaths and $3,000,000 damage. A bomber crashing into a gas holder in Chicago, Illinois, April 6, 1943, caused twelve deaths and $1,265,000 damage. A substantial number of losses less spectacular in the number of lives lost and property values involved have been reported.

Sprinkler Leakage Insurance. The automatic sprinkler system is a device designed to make fire, itself, a watchman. A building protected with a sprinkler system is piped throughout in accordance with rating specifications, and at given intervals, "heads" are set. These heads are designed to open if the temperature rises to a predetermined point. Thus, when a fire occurs in the vicinity of a sprinkler head, the head is opened and water released on the fire. Water damage caused by the opening of sprinkler heads to extinguish an accidental and unfriendly fire is covered under the property damage fire policy.

It frequently happens, however, that because of some unforeseen or accidental cause water is discharged from the sprinkler system when no fire is involved. In such an instance the fire policies do not cover the damage, and to supply the needed protection, the sprinkler leakage contract is written. This policy provides indemnity against direct property loss or damage caused by the discharge or leakage of water or other substances from within an automatic sprinkler system. In addition to damage from water from the heads, the coverage extends to leakage from valves, pumps, pipes, tanks, and supply mains, as well as direct property loss or damage caused by the collapse or fall of tanks forming part of the system. Outside sprinkler systems, or water curtains when supplied from the sprinkler system, are ordinarily not covered, but when deemed desirable the coverage may be added to the policy for an additional premium.

The insurer is not liable for loss or damage caused by seepage or leakage of water through building walls, foundations, or sidewalks or by condensation or deposits on the system itself, or by floods or backing up of sewers or drains, or by water from any source other than the leakage of the sprinkler system itself.

A special rating committee of a conference known as the "Sprinkler Leakage Conference" rates all sprinkler leakage risks. Rates are based upon the susceptibility of the subject of the insurance to water damage, with charges for any element peculiar to the risk that might increase the hazard, such as: inadequate heating, alarm system, water supply, care and supervision, infrequent tests; and ineffective type of sprinkler and installation.

Policies may be written for a year or for a longer term. Though companies usually require at least a 10 per cent coinsurance, a lesser or greater percentage may be used, 25 per cent being the customary amount. On very high-grade risks, complementary sprinkler leakage

policies are issued in conjunction with fire policies. Such risks must first be submitted to the Sprinkler Leakage Conference and, if acceptable, are placed in a special classification. Rates are reduced so sharply, as the percentage in the coinsurance clause is increased, that the insured will do well to consider carefully the advisability of a high amount of insurance with a high coinsurance clause. In mercantile risks, furniture and fixtures may be insured at the building rate, plus 50 per cent. Because the building rate is less than the contents rate, to exclude fixtures from the contents policy and cover this item specifically will result in a material saving in premium.

Sprinkler Leakage Liability. An insured may find himself liable for loss or damage to the property of others because of a leakage in his sprinkler system. This liability may grow out of the operation of the law, or it may be an assumed liability. An example of the operation of legal liability is presented in a case in which an owner of a building agrees to furnish heat to a tenant and, because of insufficient heat, a freeze-up occurs, causing a sprinkler leakage with resulting damage. An example of assumed liability is to be found when property of others is left in the custody of the insured, and by contract he assumes liability for loss or damage.

Legal liability and assumed liability may be covered under a sprinkler leakage contract. A sprinkler leakage liability policy, as ordinarily written, covers only the legal liability of the insured and does not extend to cover the assumed liability. If this coverage is required, it must be added by endorsement.

Water Damage Insurance. Sprinkler leakage insurance limits coverage to losses originating in the leakage of the system itself and does not extend to cover water losses caused by the leakage of plumbing or heating systems, elevator tanks and cylinders, standpipes for hose, roofs, leaders, spouts, or damage caused by rain or snow driven or admitted through broken or open windows or skylights. Water damage insurance provides indemnity for direct loss or damage caused by accidental leakage or by rain or snow. Leakage from a sprinkler system is excluded, and the policy is written to include only such sources of leakage as the insured may desire covered.

Water damage insurance extends to cover losses caused by the backing up of snow under the roofing to damage the interior of the building, the freezing and bursting of pipes, the overflow of bathroom or other fixtures, the leaking of the heating system, the driving of rain

through windows left open, and many other losses similar in nature.

The policy excludes losses caused by fire, lightning, tornado, windstorm, earthquake, explosion, blasting, riot, civil commotion, military or usurped power, or order of civil authority, as well as seepage through building walls and sidewalks. In addition, damage from floods, tides, and the backing up of sewers is excluded.

The policy may be extended by endorsement to cover losses caused by the breakage of street water mains or fire hydrants. Likewise, brine and ammonia refrigerating systems may be insured against accidental leakage. Consequential loss due to temperature change, in this case, is not covered, but only direct damage caused by contact with the leaking substance.

Water damage and sprinkler leakage coverages in no way overlap. The hazards covered by each are entirely distinct. As in the case of sprinkler leakage, the water damage policy may be written to cover the insured's liability for damage to the property of others, as well as use and occupancy, profits and commissions.

Rain Insurance. When it is recognized that a tornado or earthquake may do sufficient damage to a building to terminate the fire coverage, and yet a fire following may do most of the damage to the insured property, it will be recognized that earthquake and tornado coverages are a logical extension of fire insurance. When windstorm use and occupancy coverages are written, indemnity is provided for loss of profit and expense incurred, rather than for property damage. It is but a step further to provide such indemnity for losses when only a single day or a single event is concerned. Hence, fire insurance companies now provide a rain insurance coverage, which indemnifies for loss incurred as a result of rain, hail, snow, or sleet.

Rain insurance is emergency protection, and a special set of rules has been developed for this particular coverage. Unlike other insurance coverages, rain insurance attaches for a very brief period, usually but a few hours of a single day. Consequently, time is a most important factor in underwriting. The hours covered must be consecutive and specific, and a definite amount of insurance must apply to each period. Likewise, care must be exercised to avoid confusion between daylight saving time and standard time, some policies recognizing the daylight time as standard at the place where the insurance covers against rainfall.

To place rainfall insurance, an application for the policy must be

made at least seven days before the policy attaches. Local agents are not authorized to bind rainfall insurance without special company authorization, and no business is accepted until the premium due has been paid in advance. Rain insurance is designed to reimburse for actual loss sustained; consequently, an insurable interest must be shown by the applicant, and the amount of insurance written is based upon previous experience as to income and expense or, in the case of a new venture, moneys actually expended. Large sums are expended for the preparation of a great many events which in the event of rain will suffer a severe shrinkage of income or will have to be abandoned entirely.[6]

The rain insurance policy is written providing an indemnity for loss in the event that rain falls within the hours designated in the policy. The hours designated must be at least three consecutive hours and need not be the hours of the event. Any period may be designated that is deemed to be of importance in affecting the event if rain falls. Thus, in the case of a concert at eight in the evening, the hours covered by insurance might be from four to seven o'clock. The choice of these hours might be based upon the assumption that rain in the late afternoon and evening might cause prospective patrons to change their plans. Certainly there would be little loss to the event if there were no rain until after the hall was filled.

The most widely used form of rain insurance is intended to insure events with an income expectancy. There are several other forms designed for special situations. For example, there is an abandonment form designed to cover costs for preparing for an event where the costs will be lost if rain requires cancellation. A special form is available for events for which reserve seat tickets have been sold subject to refund in the event of rain. Each form is designed to fit a particular situation, and there is scarcely any event to which rain may bring a loss but may be covered adequately by one of the rain insurance forms.

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[6] Among the events which should be covered by rain insurance, since rainfall will bring a loss, are the following: auction sales, automobile races, aviation meets, band concerts, baseball and football games, bazaars, boat excursions, carnivals, celebrations, chautauquas, church fairs, circuses, clambakes, club and fraternal events (indoor and outdoor), concessions, conventions, dances (indoor and outdoor), excursions, expositions, fairs, field or track meets, golf matches, horse races, lawn parties and picnics, livestock sales, parades or pageants, polo matches, prize fights, real estate sales, rodeos or round-ups, shore dinners, special and holiday sales of merchandise, tag days, tennis matches, and winter sports events.

Rain insurance rates are based upon weather conditions and vary with the season and location of the risk. Because, within limits, weather conditions may be forecast, insurance carriers have set the seven-day limit for filing applications for insurance. For the same reason, it is deemed equitable to make the policy noncancellable. When the risk has been assumed and the policy issued, the insured is not allowed to change his mind and demand the return of his premium as the day covered by the insurance approaches; nor may the company withdraw from its bargain.

Flood Insurance. Insurance against rising water is to be distinguished from insurance against leakage or rain. The term "flood insurance" is applied to forms covering against direct loss by flood, such, for example, as the overflow of a river, or a tidal wave. The statement is frequently made that flood insurance is unobtainable in this country. As a matter of fact, loss or damage caused by floods is covered under fire and marine contracts, but the protection is usually incidental to a more comprehensive coverage. Straight flood insurance, if obtainable at all, is very rare coverage.

The usual all-risks marine coverages, or marine policies covering the perils of transportation, include loss or damage from the rising of navigable waters, and special coverages are sometimes incorporated in the form. Baled cotton in the Mississippi flood area has been successfully insured against flood loss, the risk at times being pooled and carried by an association of companies. Policies covering on bridges and their approaches may include, among other hazards, flood loss. Insurance against loss to growing crops, buildings, or land is not commonly written.[7]

Yard Improvements Insurance. Coverage is available to indemnify the insured in the event of loss or damage to yard improvements, and includes within its scope damage to trees, hedges, shrubs, plants, fences, pergolas, arbors, ornamental steps, bridges, fountains, bird

[7] The difficulty attendant upon writing flood insurance is based upon the impossibility of getting a sufficient distribution of risks. In places subject to flood only at long intervals, the demand for coverage appears when the flood starts, and during other periods, when the risk is remote and the insurers might be enabled to accumulate a reserve, there is a reluctance on the part of property owners to pay the premiums. In any case, such demand as there is for flood insurance comes from localities where the flood record is already high. Any distribution of coverage, such as the fire companies obtain, is impossible. Under such circumstances, flood insurance can be effected, if at all, on property subjected to frequent flood losses only at a rate that seems prohibitive to the prospective insured.

baths, seats, benches, and permanent betterments of every sort. Unless such improvements are specifically insured or incorporated by endorsement in the fire and windstorm policies, the policies covering on the buildings do not cover them.

The form ordinarily used excludes loss or damage caused by sleet or freezing, as well as loss or damage to any tree, unless the trunk or a main branch is destroyed, and a limit of $100 is placed for each tree. In some jurisdictions a pro rata distribution clause and a coinsurance clause are mandatory; in others, their use is optional. The pro rata distribution clause, when used, limits the insurance on each item to that proportion of the coverage that the value of the particular item bears to the total value of all the items covered.

Depreciation Insurance. Depreciation insurance provides indemnity for expenditures the insured is obliged to make over and above the amount of the loss covered by full insurance under the standard fire policy in order to restore the property to its usefulness as before the loss or damage. Since the standard fire policy assumes liability for loss only to the extent of the actual cash value of the property insured, ascertained with deductions for depreciation, it follows that in the case of older properties many losses are settled for an amount less than it will cost to replace the property. For example, it is quite possible that a part of an old factory building could be destroyed leaving the undamaged portion virtually valueless. If, for example, the boiler house were destroyed, the factory could not be operated until a new boiler house were built. On the other hand, if the destroyed structure were very old, the insurance company would not be liable for the cost of building a new structure. The owners of the factory, on the other hand, may rightfully contend that the boiler house served their purposes well, and the cost of building a new building over and above the amount of collectible insurance represents a loss not covered by the policy. It is to meet a situation such as this that depreciation insurance is written.

Insurance underwriters are very careful in writing this form of insurance because it is felt that to provide "new for old" introduces an element of speculation into the insurance contract and becomes, therefore, a breeder of moral hazard. There are, however, very real situations in which the depreciation risk is a matter of concern to the property owner. These are the situations in which the insured would be obliged to restore his property to usefulness at a cost in excess of

the depreciated value but would not, himself, derive any appreciable benefit from the increased cost.

Extended Cover Endorsement. To eliminate the necessity of writing a number of supplemental contracts providing for such hazards as windstorm, cyclone, hail, explosion, riot, aircraft, smoke and vehicle damage, an all-embracing endorsement known as the extended cover endorsement or supplemental contract has been made available. Under this form, more comprehensive insurance is provided without the detail involved when a number of separate contracts are necessary to obtain the same protectioin. The development of this form is considered one of the most important of the steps recently made in the fire insurance business. The contract has been modified from time to time, and it is still in the process of evolution. When, however, a comprehensive coverage is deemed desirable, the form admirably meets the need.

In circumstances in which all the perils insured under the supplemental contract are not deemed to be of serious consequence, insureds will continue to select the perils they wish to insure and provide coverage under individual contracts. Under the supplemental contract, a consequential damage endorsement is obtainable, extending the insurance to include all loss or damage due to change in temperature or interruption of operations when such change or interruption results from riot, or strike, or occupancy by striking employees. This last-named peril will be recognized as covering hazards of the sit-down strike.

The cost of the protection provided in this manner is less than that of separate policies. The inclusion of all the coverages in a single policy likewise eliminates any possibility of friction concerning the limits where one policy ceases to cover and the other begins.

This coverage is effected by endorsement on the standard fire policies covering the risk. Because of this, it is essential in securing this coverage to see that all policies on the risk are endorsed. To fail to do this may result in the insured's not being able to collect a loss in full, because each company assumes liability for the perils insured against only in that proportion that its own policy bears to the total fire insurance carried on the property.

Tenant's Improvements and Betterments. It frequently happens that a tenant, in order to improve the property and make it more

suitable to meet the needs of his business, expends substantial sums upon a property held by him under a lease. Improvements of a permanent nature are ordinarily absorbed into the realty and, therefore, become the property of the lessor. Obviously, however, the use value of the improvement is in the tenant, and its destruction would entail a financial loss.

The insurable interest of the tenant is covered under a tenant's improvements form. The extent of the insurable interest differs with the term of the lease. If the improvements are of a nature that permit removal and the conditions of the lease allow their removal at any time during the term or at its termination, the insurable interest of the tenant is the sound value of the improvements. If, however, the improvements are not removable, it is customary to consider the insurable interest as diminishing as the lease tends toward expiration, with its extinction at the termination of the lease. Thus, an expenditure of $10,000 at the beginning of a ten-year lease would be regarded as having a tenant's insurable interest of one-half the sound value of those improvements at the end of five years.

The fact that the tenant has a constantly decreasing interest, while the owner has a potential interest in the full value of the improvements from the time they are installed, makes double insurance a real danger. Wherever possible, a satisfactory coverage may be effected by covering owner and tenant under a single policy, as their respective interests may appear at the time of the loss or damage. When so written, the loss, if total, is apportioned between owner and tenant on the theory that the owner's interest increases as the tenant's decreases. In the case of a partial loss, the insurance is paid to both jointly on the assumption that it will be used to replace the damaged property.

Accounts Receivable Insurance. This contract provides indemnity for losses sustained through inability to collect outstanding accounts caused by the destruction or damage of the records. The standard fire policy excludes such losses. The accounts receivable cover is effected by a special endorsement to the fire policy. Ordinarily, insurance companies will not write the coverage unless the records are maintained in a suitable safe. Underwriting requirements of the various companies differ. Some require that a duplicate set of records be so maintained that they will not be exposed to loss if

a fire develops in the location where the originals are maintained.

Uncollectible accounts are not insured, nor in the ordinary course will a company cover balances over a year old.

Accounts receivable insurance is to be distinguished from credit insurance. Accounts receivable insurance indemnifies for loss growing out of the destruction of records and accounts. Credit insurance indemnifies for loss growing out of the insolvency of the debtor. Because the insolvency of the debtor, or inability to collect the account because the debtor is a poor credit risk, is not a factor in accounts receivable insurance, the policy provides that a reasonable period be established to permit customers to make payments on outstanding accounts. The period varies and may be three months, six months, or any other time agreed upon. When the period has elapsed the adjustment is completed by basing the amount of the loss upon the sum of the insured accounts found not to be collectible.

Contract of Supply Insurance. This contract is written to protect the insured against loss due to the interruption of a supply of material or goods. The policy is issued, ordinarily, to manufacturing plants which have arranged for raw material or manufactured parts at a particularly favorable price that cannot be duplicated, either because of an advance in market prices, or because, if bought elsewhere, freight and other charges would advance the cost. The loss that would accrue because of the interruption or delay, if the interruption is caused by an insurable hazard, may be covered by the contract of supply policy. The usual hazards insured include fire, windstorm, explosion, and riot. The risk of riot is usually covered when the strike hazard is a matter of concern.

The contract of supply policy is a direct-loss coverage and is to be distinguished from the consequential loss contract that pays for the interruption of business due to inability to get raw material or goods. The contract of supply policy presupposes a free market and an ample supply of raw material or goods, but is predicated upon the condition that the contract under which the insured is operating is so favorable that to go into the open market and obtain material will result in a loss. The measure of damages under the contract is the difference in price paid by the contract held by the insured, and the price he must of necessity pay in the open market if his contracted supply is interrupted.

Deferred Payment Insurance. Deferred payment insurance pro-

tects sellers against loss or damage to the goods sold and delivered but not fully paid for. It may be written to cover losses caused by fire or by the other hazards insurable by fire companies, such as windstorm, earthquake, explosion, riot, or the like. Two forms of policy are available. The first assumes liability only for unpaid balances due the insured; the second covers the interests of both seller and buyer.

It will be recognized that a merchant, having sold on a partial payment plan large numbers of high-priced items in a community, stands to lose his interest in any item if the building in which it is located burns; but, further, in the event of a catastrophe destroying a considerable section of the community, his loss might be far greater than he can afford to bear.

When the policy is issued, an estimate of the insurance required for the year is made, and the policy written for that amount. The policy is subject to the 100 per cent coinsurance clause, which is mandatory. The coverage is adjusted by means of monthly reports of sales or balances, depending upon the type of coverage. At the end of the policy term, an average of the values reported is made by adding them, and dividing by twelve. A premium is computed on the basis of the reported values as averaged, and this represents the premium charge for the year. If this is in excess of the premium collected on the estimated amount when the policy was issued, the insured is billed for the difference; if less, a return premium is paid to the insured.

The rate for the coverage is the average rate of all locations where goods are insured. When only dwellings are involved, there is little question in fixing rates, for dwellings, with an occasional exception, are written at much the same rates. When the policy covers large installations in manufacturing plants and the like, considerable care is required in compiling information for computing the rate.

Deferred payment insurance is written sometimes to cover in excess of specific insurance. In any case, it is provided in the policy that there is no liability for loss on any property having the insured's interest covered by specific insurance until all other insurance covering the property has been exhausted.

Standard Mortgagee Clauses. By far the most common and the most satisfactory means for protecting the interest of the mortgagee is to be found in the use of the standard mortgagee clause. There are two forms in common use: the one referred to as the "full contribu-

tion mortgagee clause," and the other known as the "noncontribution mortgagee clause."

Both are identical with the exception of the contribution clause in the case of the full contribution mortgagee clause, which makes the following provision:

> In case of any other insurance upon the within described property this company shall not be liable under this policy for a greater proportion of any loss or damage sustained than the sum hereby insured bears to the whole amount of insurance on said property, issued or held by any party or parties having an insurable interest therein, whether as owner, mortgagee, or otherwise.

The effect of the contribution clause is apparent, and when used it is imperative that all policies covering the property be written concurrently. When the noncontribution clause is used, the mortgagee may proceed under such policies and require to be paid to him the full amount of the loss or damage without reference to other policies covering on the property. The noncontribution form is deemed most favorable to the insured, the contribution form better protecting the interest of the company; though if all policies are identical, using either form, the protection is identical.

The clause as it has developed and court decisions that have interpreted it hold that the clause attached to a fire insurance policy constitutes a separate and distinct contract between the insurance company and the mortgagee, vesting the mortgagee with legal rights as a contracting party. The agreement is far more liberal and the terms of the contract are more generous than any other insurance contract that it is possible for an insured to obtain. Every device conceivable to protect the interests of the mortgagee has been incorporated into the clause, with the result that the broadest and most complete form of protection has been thereby provided.

So far as the company is concerned, the right of subrogation is reiterated. Provision is then made that if the owner default in premium payment, the mortgagee shall pay on demand. The question has been raised as to the extent of the obligation this provision places upon the mortgagee. It has been advanced that the mortgagee is obligated to pay the entire premium upon failure or inability of the insured to do so. This, however, is not regarded as the correct interpretation. It has been rather held that, upon failure of the insured to pay the premium, the mortgagee must pay it upon demand if he desires

the insurance to remain in effect. Upon refusal of the mortgagee to pay, the policy may be canceled, the mortgagee not being liable for payment of premium earned previous to the making of the demand.

The great liberalizing feature of the clause is that which provides that the policy shall not be invalidated by any act or neglect of the mortgagor or owner of the property, by any foreclosure or other procedure, by any notice of sale relating to the property, or change in title of ownership, or increase in hazard. The clause is regarded as affording in all states a broad and liberal protection of the mortgagee's interests.

Such duty as is imposed upon the mortgagee by the clause is concerned with changes in ownership, occupation, or increase in hazard, when such changes are a matter of knowledge of the mortgagee. If the change is one not permitted by the policy without endorsement thereon, such endorsement, upon notice, may be made by the company. If the hazard is thus increased, the insurer may make demand upon the mortgagee for the premium, which the mortgagee is obligated to pay; otherwise, by the terms of the agreement, the policy becomes void.

Errors and Omissions. Banks, trust companies, mortgage corporations, building and loan societies, and other like institutions demand insurance policies properly endorsed, with the mortgagee clause covering their mortgage interest in property securing a loan. The checking of insurance and the supervision of renewals become no small or unimportant task. Unlike the individual who occasionally lends on mortgage security, the financial institution has hundreds of loans daily, and the danger of an error in checking the vast number of policies involved is very real.

To provide against loss arising out of a failure to have in force the proper insurance to protect mortgaged property through errors or omissions, insurance coverage has been devised. The coverage protects the mortgagee, and him only, against loss from fire and lightning when through error and omission specific insurance is invalid, or insufficient, or has not been provided. The error or omission must arise out of some unintentional act of either the mortgagor or mortgagee, and as a result of such act, the collateral of the insured must be actually impaired, thereby causing the loss.

While there are a number of different forms upon which the

coverage is provided, they are alike in their essentials. The rates are low, ranging from 2 cents to 5 cents per $100 of insurance. Twenty-five per cent coinsurance is usual.

It is not the purpose of the errors and omissions policy to relieve the insured of his obligations regarding the careful supervision of the policies held. As a matter of fact, it would be difficult, if not impossible, to secure the coverage if the institution could not demonstrate a carefully worked out plan of follow-up for insurance policies and their renewals. The number of technical problems involved, however, indicate the danger of error and the loss that might arise therefrom.

The most prevalent errors from which losses arise involve the elements of carelessness, delay, or oversight. It may happen that the mortgagor has agreed to deliver his policies to the bank. Before he can do so, a loss occurs. After the loss, it develops that his insurance is insufficient to cover the mortgage debt. The errors and omissions policy indemnifies the mortgagee to the extent of his loss. When property is sold, and the deeds are passed, but the insurance, through oversight or inadvertence, is not transferred, the errors and omissions would step into the breach to protect the mortgagee. Changes in ownership, incorrect description, errors in entering expirations at the bank, failure to report change of occupancy or increase of hazard when known, errors in ordering or binding coverage, incorrect statement of ownership, oversight in ordering renewal—these and scores of other errors that might invalidate the coverage or jeopardize the protection are protected by the policy.

Another important hazard covered in the policy is concerned with coinsurance. When there is not insurance enough to value, both insured and mortgagee are affected by the operation of the clause. Naturally banks take precautions to see that proper insurance to value is carried. If it appears after a loss that the insurance is insufficient, the bank is protected by the errors and omissions coverage.

The most important obligation assumed by the insured is to use every reasonable effort to secure and maintain specific insurance. Some forms require an audit or check of all policies at least once a year, and upon the discovery of an error or omission, the insured is obligated immediately to secure specific insurance.

Supplemental Mortgage Interest. In some communities where banks, trust companies, building and loan associations, and mortgage

companies have made heavy loans and, because of the custom in vogue in the community, have not required their borrowers to protect the mortgaged property with insurance against the perils of windstorm, earthquake, explosion, or riot, they have taken steps themselves to insure the risks. While an individual loss from such a source might not seriously handicap the lending institution, it recognizes that a financial disaster might be the outgrowth of a huge, unprotected loss. This might readily happen, as it has in the past, as the result of earthquake or tornado.

The blanket supplemental policy, as written to cover the mortgage interest of financial institutions, furnishes no protection whatever to the property owner, and there can be no payment in any instance of an amount greater than the mortgage interest of the insured in the damaged property, regardless of the extent of the damage or the value of the property. Nor can the insured collect under the policy until the security has been so impaired that the loan no longer has adequate protection.

In addition to the coverage for damage from earthquake and windstorm, which are most likely to be the sources of catastrophe, riot and explosion risks are frequently added, and there is included in some forms coverage for loss or damage caused by falling aircraft.

Automatic and Open Binders. Automatic binders are available for banks and trust companies acting in the capacity of executor, administrator, trustee, guardian, or conservator. The insured is automatically covered for an amount up to a stipulated limit against loss or damage by fire to any property passing into its control in any of the above-mentioned capacities.

The insured is obligated within the sixty-day period to ascertain the insurance in effect upon the property, and any deficiency is to be written in the company writing the automatic binder. By means of this coverage, continuous fire protection is provided from the time the property passes into the control of the financial institution, making good any deficiency pending the insured's having an opportunity to check the existing coverage.

An open binder is issued to a bank and is designed to indemnify it against loss sustained through the impairment of its mortgage interest because of fire, when such loss is covered by specific insurance in an insolvent company. The company issuing the binder automatically covers the insured for a period of thirty days when a company

placing specific insurance on the mortgage interest of the insured becomes insolvent. Within thirty days the insured is obligated to replace the insurance in the insolvent company, with a like amount of insurance in the binding company. A nominal premium of one dollar is charged for the binders.

Automatic Builder's Risk. A building in the process of construction offers a particular insurance problem. A builder's risk form covers not only the structure itself but also material, equipment, supplies, and temporary structures of all kinds used in connection with the construction, as well as machinery, tools, and equipment while in or attached to the building in process, or in or near the premises described in the policy.

The question of coverage concerns itself primarily with amounts. A building in process is continually adding to its value as construction progresses, or as material arrives. To add to the policy from time to time involves one of two situations. The building will from time to time be underinsured or, if this situation is anticipated, it will from time to time be overinsured with a resulting excess cost of insurance.

To meet the situation, the automatic reporting form has been devised. This form automatically adjusts the insurance in effect to values as they are added. The policy is written stating a limit of liability which should, as nearly as possible, approximate the actual cost of the building in its completed form. As value is put into the building, reports are made at monthly intervals, and the coverage automatically follows the value between reports.

This may be illustrated as follows: Assume that a building that will cost $100,000 on completion is in the building process for five months. A policy is written for $100,000 at the beginning of construction. It covers, however, whatever values have been expended to the date of the loss, subject to the limit of $100,000. If, for example, at the end of five months a value of $50,000 were at risk in the building, this sum would represent the report made to the company. If $10,000 were added during the next month, the month-end report would show the value of $60,000. If, however, a loss occurs just before a report is made, the insurance because of its automatic coverage feature has followed the value, and the insured is fully covered, regardless of the fact that the last report made was nearly $10,000 less than the loss.

Premiums are adjusted, not on the basis of the original limit stated in the policy, but on the basis of the monthly reports. To make

this adjustment equitable, if a report on the last day of the month shows an added value of $10,000, the additional $10,000 coverage is charged from a date neither at the beginning nor at the end of the period, but from fifteen days prior to the date of the report. The additional premium is computed and billed to the insured each month. In some jurisdictions, an initial deposit premium is required, and the premium adjusted on the basis of the monthly reports.

The 100 per cent coinsurance clause is mandatory. The interest of the contractor, or owner, or both may be covered under the policy, and the hazards of earthquake, windstorm, explosion, riot and civil commotion may be covered, in addition to the regular fire coverage.

Completed Value Builder's Risk. An alternative form of builder's risk available in some jurisdictions is designed to eliminate the necessity of monthly reports. When this form is used, insurance equal to the completed value of the property is placed at the commencement of construction; as in the case of the reporting form, full insurance to value is required. To compensate for the fact that more insurance than value is carried at the inception of the contract, an adjustment in the premium is made by fixing the rate at 55 per cent of the 100 per cent coinsurance builder's risk. The policy is, in the ordinary course, written for a period of one year, and in any case the cover terminates when the building has been completed. If the building is not completed within the policy period, the term may be extended by endorsement. If a fire occurs during the period of construction, full insurance coverage is provided.

Multiple-Location Contracts. The trend of business has been in the direction of larger and larger organizations, each controlling subsidiaries or branches, frequently with property values distributed among many locations. To simplify the problem of providing complete and adequate protection, the multiple-location forms have been prepared, whereby all locations may be covered by a single policy, with automatic coverage for new locations.

Reporting forms, which do not cover buildings, but contents only, are used. Insurable items include merchandise, machinery, supplies, furniture, fixtures, and the insured's interest in betterments. Furniture and fixtures, machinery, and the like can be written only in connection with merchandise. For this reason, risks, such as banks with numerous branches, barber shop chains, theater chains, and other similar lines, cannot be written on a reporting form. The rea-

son for this is at once apparent when it is recognized that the reporting forms are designed to take care of fluctuating classes of merchandise where an automatic coverage following values is desirable.

The multiple-location reporting forms are commonly referred to as "I.U.B. Forms," the name being derived from the Interstate Underwriters Board, organized to supervise these coverages. The board has for its members fire and marine insurance companies, and it maintains an organization, under a governing committee of leading insurance officials, equipped to authorize insurance on eligible risks, and in general supervise the writing of this class of business.

The insurance is written under two general types of coverage. To the first type, the term "multiple location" is specifically applied, and the insurance is written at a published average rate. There are three forms under this first division: forms no. 1 and no. 2 are reporting forms; form no. 5 is a nonreporting form, written with a coinsurance clause. The second classification of coverages is written, not on a published average rate, but at the specific rate for each location. This second group uses two forms: form A and form B. They are sometimes referred to as "single-state reporting forms." The term is a misnomer for, regardless of origin or the early intent of the designers of the policies, single-state forms are not of necessity confined to one state but may cover in one or several states. There are some differences in the rules and uses of the two groups.

Class Floaters. It sometimes happens that business establishments have small amounts of inventory located on the premises of a large number of different distributors. Because of the nature of the stock and the method of handling the accounts, it is not convenient to cover the various locations under an I.U.B. form or a single-state reporting form because of the difficulty and the detail involved in securing adequate monthly reports. Small consignments of this nature are frequently covered by the so-called "class floater," which provides insurance without specific mention of locations and without requiring regular reports within a designated territory indicated in the policy. Companies usually limit their commitments on this type of policy to a sum not in excess of $2,500 on any one loss. If the exposure is greater than this, it is expected that the account will lend itself to one of the regular reporting forms.

The policy is designed primarily for business establishments that consign small amounts of merchandise to gas filling stations, repair

shops, tire stores, and the like. Locations and amounts of merchandise in each location are small, but vary so constantly that the floater seems to be the only satisfactory method of providing the coverage.

Standing Timber Insurance. The insurance of standing timber is, from the standpoint of underwriting, a highly specialized form of cover. It is readily recognized that a fire involving serious loss is from the point of view of the insurance underwriter in all probability liable to develop into a catastrophe. The demand for this form of insurance made its appearance when tracts of standing timber were included in the security offered lending institutions in connection with the negotiation of loans.

Standing timber insurance contemplates two types of risk: (1) merchantable lumber, and (2) reforestation plantation. The merchantable lumber classification includes timberlands containing a growth of a size that permits profitable operation for saw logs. Reforestation plantations include trees planted by hand, in contrast to second growth that has developed from seed. In the case of merchantable lumber, in the ordinary course, companies tend to limit their commitments to $25,000 subject to one fire; and in the case of a reforestation plantation the limitation is fixed at the actual outlay for trees and labor plus interest at 5 per cent from the date of planting, compounded annually.

Whereas the policy is written on an annual basis, the major fire hazard exists during the summer months. For this reason, the companies regard the months from April to November as the dry season and make for that period what is known as a "dry season charge." If the policy is in force during any part of the dry season, the dry season charge is regarded as fully earned, and no return premium for any part of it is allowed. This charge represents 80 per cent of the annual premium.

FOR REVIEW

1. A building adjoining the property of B was destroyed by fire. The burning building collapsed, carrying with it a large part of the building belonging to B. B's insurer claims that because of the fall of the building the fire policies ceased to cover. Is the damage, in your opinion, collectible under the fire policy?
2. A building located on a bank of a river is undermined by a flood, and a small part of one wing is carried away. The destruction of the wing upsets a heating plant, and the building is totally destroyed by fire. The insurance carriers deny liability on the ground that the collapse of the building has canceled the policy. Can the insured collect?

3. A fire in an adjacent building causes a serious explosion that wrecks the building of B. B claims fire to be the proximate cause of his loss and asks his fire insurance companies to settle. Are they liable?
4. Sprinkler supply tanks are often located on the roofs of industrial buildings. These tanks may hold as much as eighty tons of water. The collapse of such a tank, due to defective or damaged supports, results in a terrific property damage loss. Is this covered by the sprinkler leakage policy?
5. Has the insured any responsibility in respect to the measurement of rainfall under a rain insurance policy?
6. Has a local agent authority to issue a binder for rain insurance?
7. A sudden change in the temperature of a building causes heavy condensation on the pipes of the sprinkler system. Water dripping on a stock of silks and laces causes severe damage. Is this loss covered under a sprinkler leakage policy?
8. A tornado severely damages a building and among other effects causes a sprinkler system to open. Is the water damage so caused covered by the sprinkler leakage policy?
9. It is sometimes stated that most sprinkler losses are occasioned by the accidental opening of the sprinkler head. This rings an alarm. For this reason it is said that sprinkler losses are ordinarily small. Can you indicate accidents that may be the occasion of severe losses?
10. Is it possible to insure rents, rental values, profits and commissions, use and occupancy, and leasehold interests under a sprinkler leakage policy?
11. An enterprising agent suggests to a group of friends that they pay the premium and purchase a rain insurance policy. They select an event in which they have no financial interest and buy a policy covering against $\frac{3}{10}$ inch of rainfall during a period of three hours. Rain in excess of $\frac{3}{10}$ inch falls within the stipulated period. May the insureds collect the amount provided in the policy?
12. The rain insurance regulations require that an application be filed, and the premium paid at least seven days before the coverage is to be effective. May the policy be canceled and the return premium collected prior to the effective period of the insurance?
13. May a rain insurance policy be written in conjunction with a fire insurance policy, tornado insurance, or any other hazard insurance?
14. An airplane crashes, striking a building causing a severe sprinkler leakage loss. Does the sprinkler leakage policy as written cover such a loss?
15. The X department store has a sprinkler system installed. A plate glass window is broken causing the pipe and head in the window to freeze. As a result of the freezing the system opens, and there is a water damage loss. Is this loss covered in the sprinkler leakage policy?
16. X is the manager of a carnival being held for a community benefit. He is advised to buy rain insurance. The policy covers for three hours from noon until 3 P.M. A heavy downpour damages the decorations to the extent of $400. Estimated loss of income is $1,000. May both of these items be included in the claim?

17. A case is reported of a terrific downpour of rain that washed a car garaged near the bank of a creek into the stream. The car was found the following day, a total wreck. Does the collision insurance coverage indemnify the owner of the car?
18. The Blank Refrigerating Company carries a water damage policy. Liquid ammonia escapes from a broken pipe, vaporizes, and destroys a stock of foodstuffs. Is the loss covered by the policy?
19. Which of the following, if any, are covered under the sprinkler leakage policy against losses caused by overflow or leakage therefrom:
    a) Plumbing system
    b) Plumbing supply tanks
    c) Heating radiators
    d) Elevator tanks
    e) Standpipes, fire hose
20. During an unusually high tide, an influx of water flows through sewers and drains into the basement of the X department store. Is the water loss so occasioned covered in the water damage policy?
21. What advantages to the owner of property in many different locations are to be found in the multiple-location insurance form?
22. Does the water damage policy extend to cover water losses occasioned by freezing?
23. Water damage policies are never issued until a careful inspection has been made by the insurance underwriters of the property to be covered. Has this inspection any value to the insured?
24. The supports of a water storage tank give way, with the result that the collapsing tank itself causes terrific damage in addition to the damage caused by the released water. Is the loss covered by the sprinkler leakage policy?
25. Through negligence of the janitor, the fires of a building are allowed to go out. Due to freezing, parts of the sprinkler leakage system burst, with resulting damage to the building of the insured and the stocks of merchandise belonging to the tenants. Are the losses covered under the sprinkler leakage policy?
26. Indicate which of the following sources of loss by water damage are covered in the water damage policy:
    a) Automatic sprinkler systems
    b) Water tanks for plumbing systems
    c) Heating radiators
    d) Steam or hot water heating pipes
    e) Reservoirs for fire protection
    f) Fire hydrants
    g) Street water mains
    h) Legal liability claims for injury to property of others caused by water
    i) Water damage caused by falling aircraft
    j) Refrigerator systems
    k) Rain or snow admitted through defective roofs
    l) Rain or snow admitted by open or broken doors or windows

Chapter XVIII

FIRE INSURANCE RATES

Rate Analysis. The premium, or charge that the insured pays for his insurance protection, is based upon a rate fixed by the rating authority to whom this responsibility has been delegated. The insured who handles his affairs in a business-like manner will not be content to be told that the rate on his building is 2 per cent per annum when he knows that across the street a property owner pays one-half of 1 per cent. First, he will want the discrepancy justified, and, second, he will require to know to what extent a downward revision of his own rate is within his control. This information is all obtainable through an analysis of the make-up of the rate.

The effort to eliminate, so far as possible, the element of judgment and substitute therefor a set of scientifically determined working rules has had the effect of making the problem of rate determination for a sizable structure a complicated and technical procedure. The average insurance agent is not equipped to make, nor will he presume to make, a rate analysis. This work is assigned to highly trained experts who have qualified by education and experience for this branch of the business. The agent and the insured, however, may take the make-up of the rate when the work is completed by the rating authority and, upon analysis, determine where it will be profitable to eliminate hazards for which charges are made and thereby reduce the rate.

Fire insurance rates as promulgated by the bureaus fall into one of two categories: (1) class, and (2) specific. Class rates are sometimes known as "tariff rates," or "minimum rates." The terms class, tariff, and minimum are interchangeable, and the term customarily used in the community is frequently the outgrowth of local custom.

Class rates apply to all properties that fall within a given category or classification. The outstanding example of class rating is to be found in detached dwelling houses. Other specialized types of structures, such as brick churches, apartment buildings, and the like, are sometimes rated by class. When minimum rates do not apply, the rate is said to be "specific." Specific rates are determined by the ap-

plication to a key rate of credits and charges previously worked out, and the system is known as "schedule rating." Schedules are almost universally used in rating mercantile and industrial property.

Minimum Rates. The earliest efforts in the direction of measuring the fire hazards for rate making resulted in the application of a rate to a particular class of structure. Early rates designated brick and stone buildings as belonging to one class, and frame buildings to another. Following this classification as to construction, risks were rated as to occupancy. The rates are the same within each class, and are termed "class rates," or "minimum rates."

In the case of private dwellings, we have an example of rating by class. Minimum rates are promulgated to apply to all dwellings not subject to some special hazard. Minimum-rated dwellings are subdivided into groups in accordance with construction, with a rate assigned to each class. The rate also varies as to the classification of the city or town and the number of families occupying the property.

In addition to minimum-rated dwellings, some jurisdictions apply class rates to buildings such as churches, apartment buildings, and others where the elements of construction and occupancy are similar enough to permit a ready grouping into rate classes.

Judgment Rating. When it became apparent that class rates were inadequate to measure the risk, when wide variations were to be found within a class, the earlier efforts to compensate for these differences resulted in rates based upon individual judgment. The inspector, or committee entrusted with the task, governed by the hazards involved on the basis of his own judgment, determined what the rate should be. Obviously, with so much depending upon the element of personal judgment, a wide variation in rates upon similar risks was to be expected.

Judgment rating occasionally makes its appearance in a limited way in connection with a risk having some extreme or peculiar features. When it is obvious that the rating system in vogue in the jurisdiction will result in a rate entirely out of line with the hazards, the element of judgment is introduced.

Class rates are, in fact, judgment rates. With the exception of class rates and the occasional exceptional structure, judgment rates are no longer in use. In their stead, a system designed to eliminate the personal factor has been substituted. The system is termed "schedule rating" and has as its aim the promulgation of a rate that is

equitable as between the parties to the contract and free from the possibility of discrimination between insureds.

Schedule Rating. The process of schedule rating involves the fixing of a base rate or a key rate. The base rate is intended to represent the charge for a standard building, unoccupied and unexposed, in a standard city and is without statistical basis. The key rate, on the other hand, is used as the initial charge to apply to the particular community in which the subject of the insurance is located. The key rate includes a measure of the degree of public protection of the community, worked out on the basis of an analysis of the fire hazards made by the National Board of Fire Underwriters. Neither the base rate nor the key rate is an average, but represents an initial charge upon which the final rate for any particular property is constructed. Using the base rate or the key rate, the specific rate for the property in question is determined by adding charges for departures from prescribed standards in construction, occupancy, exposure, or other hazards. From the sum thus obtained are taken credits for favorable features, such as fireproof construction, protective devices, and the like. The resulting figure is the rate.

With the refinements that have been introduced into the system, the personal factor has become to a very large degree submerged. With the base rate or key rate fixed, and the charges and credit predetermined through study and experience, as between one insured and another, the opportunity for discrimination is reduced to a minimum. However, because of the complexities of the schedule and the applicable rules, as well as the technical information necessary for rating, many errors creep into rates as promulgated. Where the rate maker is authorized to use judgment in fixing certain of the charges, or allowing credits as, for example, charge for faults of management or credits for superior construction and management in sprinklered risks, it is at once apparent a difference in rates may be developed by different rate makers for the same risk. With the exception of this single opportunity for the operation of the element of judgment, as between one insured and another, there is little opportunity for discrimination. It is to be remembered that the opportunity for the operation of judgment or discretion may be applied only to certain limited factors affecting the entire risk.

The two systems in most common use for schedule rating are the Universal Mercantile Schedule and the Analytic Schedule. A

third system, which undertakes to incorporate the element of experience, is known as the Experience Grading and Rating Schedule. This last system has never been actually adopted for use and is, therefore, of little practical concern to an insurer.

Universal Mercantile Schedule. The Universal Mercantile Schedule takes as its point of departure a standard building in a standard city. A standard city is described as one having wide and level streets, gravity water works, adequate fire and police protection, and building conditions meeting a rigid set of requirements. A standard building, though not fireproof, represents the ideal for ordinary construction. Therefore, in arriving at a rate under this schedule, there are two variable factors to be considered. The first involves a consideration of the city or town, and from this a key rate is determined, which serves as a point of departure for rating every individual structure. The second variable is the building itself. So far as the building under consideration possesses any deficiencies from the specifications laid down for the standard building, they are compensated for by designated charges in the rate.

Schedule rating is judgment rating to the extent that it takes, as its point of departure, an arbitrary rate. In the mercantile schedule, this rate is known as the "basis rate," and although it is in fact a judgment rate, it is carefully worked out, with an abundance of data from which to draw conclusions. Although judgment enters into the preparation of the schedule, it is largely eliminated in application. The basis rate is a figure which, in the opinion of underwriters, would secure a premium on "a standard building in a standard city," sufficient to cover fire costs in the light of experience for five years, the cost of carrying on the business, and allowing a profit not to exceed 5 per cent. Since the basis rate contemplates an ideal risk, it is of necessity low and, to meet actual situations, necessitates a number of charges for hazards found in actual conditions. The first adjustment reflects a modification of the basis rate for hazards that apply to the entire community. Specific deficiencies in the water supply, fire department, fire alarm system, police, building laws, and other structural conditions are taken into consideration. On the basis of special hazards of this nature, the basis rate is adjusted, and the rate thus determined is known as the "key rate."

The specific rate that applies to the particular building is found by making adjustments to the key rate. If there are any deficiencies

in the structure or any unusually favorable features, the key rate is modified accordingly. For all unfavorable features, additions are made to the key rate, and deductions are made for the favorable features. Thus, by computing charges based upon a schedule of specific hazards, the rate for a standard building in the particular city in question is converted into the rate for the building under examination.

Determining the Key Rate. The control of the key rate in any community falls only indirectly within the control of the insured. So far as he can throw the weight of his influence on the side of improved conditions in the way of fire defense, he can contribute to a lower community rate.

The National Board of Fire Underwriters has made a careful analysis of fire hazards in more than 500 cities, and on the basis of the results obtained has prepared a grading schedule. The plan is based upon a set of standard requirements, with the assignment of points of deficiency based, in each particular case, upon the extent of the variance from the standards. The schedule is based upon a maximum of 5,000 points of deficiency, divided in accordance with the relative importance of the factor under consideration. The deficiency points are distributed as follows:

Water supply	1,700 points
Fire department	1,500 points
Fire alarm	550 points
Police	50 points
Building laws	200 points
Hazards	300 points
Structural conditions	700 points
	5,000 points

In connection with the water supply, thirty-two subjects are considered. These include such details as: the method of appointment of employees; the efficiency of executives; the adequacy of the system and the reliability of supply, hazards, exposures, and reserve capacity of pumping station; emergency repair provisions; the reliability and completeness of main installation; distribution, condition, and size of the hydrants; and other similar points. In connection with the fire department, thirty-four subjects are checked. These include: number, qualification, and term of office of officers; number of operators; enlistment and retirement requirements; a full study of all apparatus.

including hose, pumpers, wagons, engines, fireboats, reserve equipment, and repair facilities. Discipline, drills, fire methods, and building inspections all receive attention in rating the fire department.

In connection with the fire alarm, there are twenty-four points for consideration, chiefly concerned with the accessibility of boxes and the technical operation of the system. The co-operation of the police with fire and building departments and the adequacy of patrol wagons and signal systems are considered in rating the police department. Under the heading of building laws, the fire limits, the construction and protection of buildings, and enforcement of the laws are all factors. Under the classification of hazards, conditions affecting lighting, heating, and the handling of explosives and inflammables are rated. Structural conditions involve analysis of congested areas, height of buildings, types of construction, unprotected and exposed openings, deficient party and fire walls, street widths, exposures, and conflagration breeding areas.

On the basis of the application of deficiency points, cities and towns are classified as follows:

Class	Points of Deficiency
First	0 to 500
Second	501 to 1,000
Third	1,001 to 1,500
Fourth	1,501 to 2,000
Fifth	2,001 to 2,500
Sixth	2,501 to 3,000
Seventh	3,001 to 3,500
Eighth	3,501 to 4,000
Ninth	4,001 to 4,500
Tenth	In excess of 4,500 or with extreme deficiency in water supply or fire protection.

Additional deficiencies are sometimes charged for unfavorable climatic conditions. While the board recognizes that climatic conditions affect fire losses, such as when fires are caused in cold weather by the heating hazard and spread in hot, dry weather, there is no deficiency charge where conditions are normal and represent the average throughout the country. Where, however, there are very high winds, excessive snowfalls, severe cold weather, unusually hot, dry weather, or other unusual or exceptional conditions, a deficiency termed a "super-deficiency" is added to the deficiency found by applying the schedule proper.

Classification. For rate-making purposes, buildings are classified as to construction, protection, and occupancy. There are three major types of construction: (1) fireproof, (2) brick, and (3) frame. To be classified as fireproof, or fire resistive, a building must have all bearing walls of brick, stone, or re-enforced concrete. All floors, roofs, non-bearing walls, curtain and panel walls in skeleton construction, and principal partitions must be of brick, concrete, or other incombustible material. The second group, those buildings classified as brick, are required to have walls of brick, stone, concrete, or equivalent masonry construction, though the interior and roof construction may be of wood. Frame additions, which are not in excess of one-third of the ground floor area, do not have the effect of removing the building from the brick classification. All risks not classified as either fireproof or brick fall into the third group and are classified as frame.

A protected risk is one located within 500 feet of a public hydrant connected with a town or city water supply. Moreover, the risk must be within 1½ miles of an available, regularly organized and equipped fire station. If the station is equipped with motor-drawn apparatus, the limit is extended to 2 miles.

As to occupancy or use, there are six general classifications which in turn are variously subdivided. The six major classes are as follows: (1) nonhazardous; (2) mercantile; (3) manufacturing specials; (4) non-manufacturing specials; (5) warehouses; (6) sprinklered.

In the first group are to be found churches, chapels, public buildings, educational institutions, hospitals, asylums, jails, dwellings, farms, and growing crops. The second classification includes wholesale and retail mercantile buildings, warehouses, offices, banks, and telephone exchange buildings, and, generally speaking, the stocks and furniture in such buildings. The third group includes both building and contents of woodworking plants, sawmills, all classes of mining risks, cotton gins, cereal and flour mills, food products factories, breweries, distilleries, ice factories, and other similar risks. In the non-manufacturing groups are to be found railway and traction properties, light and power plants, lumber yards, tobacco barns, cotton and tobacco warehouses, stemmeries, rehandling houses, and the like. To be included in the last group, the risk must be equipped with an approved automatic sprinkler system. To be classed as a sprinklered risk, all the principal hazards of property and at least 60 per cent of the floor area must be protected.

The Individual Survey. After the key rate has been determined, a survey is made of each property to be rated, and upon the basis of the findings, the final rate is computed. A study of the following form will indicate the nature of the information required and the factors upon which the rate depends.

SURVEY

UNDERLINE WORDS WHICH APPLY

WALLS. Brick, Stone, Re-Concrete, Cement Block, Frame, Stucco, Cor. Iron.....
..... Height .....
FOUNDATION. On Posts, open, enclosed; Brick, Stone, Wood.....
FRAME. Rear, Side, Front, or Roof Structure, more, less than ½ frame.....
AREA..... Total ..... sq. ft.
ROOF. Mansard, Shingle, Slate, Gravel, Composition, Tile, Asbestos, Metal .....
SKYLIGHTS. Thin, thick or wired glass; ..... Size ..... Not—screened; None
CORNICE. Wood, Stone, Metal, Brick; None .....
BLIND ATTIC. Yes, None.....CONDITION. Good, Fair, Bad
FLOORS. Single, Double,.....in. thick, Joisted or Mill Construction.....
.....
.....
FINISH. Sheathed with wood, varnished.....stories, Open.....stories
Metal, Wood, lathed and plastered.....stories
STAIRWAYS. Open.....floors; Enclosed by wood, metal, lath and plaster, Brick; None. Hatches or Doors, closed, not closed, Standard fire doors.....
ELEVATOR WELL. Dumb Waiter, Chute, Light Well, Ventilating Shaft, etc.; Open Enclosed by wood, metal, lath and plaster, brick; None.....
Hatches, self-closing, open, closed.....
CHIMNEYS. Cement, Tile, Metal, Iron, Brick; Single or double thickness; Core Resting on Shelf, post,.....floor; None.....
FUNNELS. Through wall, window, hollow partitions, floor; Safe, Unsafe.....
HEATING. Furnace, Stove, Steam, Hot Water; Safe, Unsafe; None.....
LIGHTING. Gasoline, Kerosene, Electricity, Gas; None.....
POWER. Steam, Electric Motor, Gas, Kerosene, Hot-air or Gasoline Engine, Water; None .....
BOILER. In Main Building,.....story, bk. or fr.....Ell; Safe, Unsafe.....
CUT-OFFS. None; Incomplete; Fire Walls, Standard Fire Doors, Parapet.....
.....
.....
EXPOSURE. None, North.....
East .....
South .....
West .....
.....
.....
.....
WINDOWS.....
BLANK WALL..... PARAPET.....
WATCHMAN. None, Yes; Time Detector, None; Record—good, fair, bad.....
FIRE DEPARTMENT. Steamers; Paid; Volunteer; Call. Nearest house.....ft.; None .....
HYDRANTS.....within.....ft., on.....inch main; Public, Private; None.....
FIRE ALARM BOX within.....None. THERMOSTATS.....
PRIVATE FIRE APPLIANCES. Pails; Extinguishers; Standpipe and Hose, standard; Insufficient; None .....

DEFECTS. Rubbish, Empty Boxes, etc., in cellar, closet, yard, window recesses. Gas jets or lamps swinging against wood, etc. Sawdust in spittoons or to absorb oil. Broken plaster, broken windows. Defective electrical equipment. Open lights in show windows. Ashes in wooden boxes or on floor. Naphtha, gasoline, benzine, etc., in unnecessary quantities inside. Steam pipes against wood, etc. Kerosene lamp insecurely hung.

The Rate Make-Up. It is with the specific make-up of the rate that the insured is concerned. He wishes to know for what he is being charged, how much, and whether it will pay him to correct the hazard and remove the charge. A reference to the schedule used in making up the rate will indicate the charges for the various hazards and the credits for protective devices or exceptionally good features. To find the rate of the particular building, these are applied to the key rate of the city or town. In connection with the occupancy of the structure, there are two charges. The first of these is included in computing the building rate, and the other is a differential added to the building rate to determine the rate on the contents themselves.

Schedules are adapted to the particular class of property to be rated. The following is a standard mercantile building schedule, which indicates the method of charging for hazards in arriving at a rate:

		BLDG.
STANDARD RISK	Bangor	.45
1 FRAME.		.60
2 HEIGHT. For each story over four, as follows, viz.:—		
(*a*) For five-story building, charge		.15
(*b*) For six-story building, charge		.50
(*c*) For seven-story building, charge		1.00
3 AREA. For each 1,000 feet or fraction thereof over 5,000 feet on all floors and basements.	.01	
NOTE.—See Rule for exceptions.		
4 ROOF. (*a*) Shingle, Wood or Paper		.10
(*b*) Mansard with Wooden Frame, each side	.05	
5 SKYLIGHTS. Other than Standard		.10
6 CORNICES. (*a*) Other than Standard, each side.	.05	
(*b*) If metal clad and stopped every 20 feet each side	.02	
7 INTERIOR FINISH. (*a*) Plastered or sheathed		.10
(*b*) If Sheathing is oiled or varnished, add		.05
8 STAIRWAYS. Other than Standard		.10
9 WELL HOLES. Other than Standard		.15
10 ELEVATORS. Dumb Waiters, etc.		
(*a*) Open or in wooden wells		.20
(*b*) If Elevator is in tin-lined well with *Standard* doors		.05
(*c*) If Dumb Waiter is tin-lined with metal-clad doors		.05

	NOTE.—When Stairways and elevators are together or in same well hole, make the higher charge only. No charge for No. 8 above 1st story in buildings not over 4 stories high, occupied only for offices and dwellings above first floor.		
11	HEAT. Other than Standard		.10
12	LIGHTING. Other than Standard		.10
13	POWER. Steam Boiler not Standard		.10
14	OCCUPANCY. (*a*) Each mercantile occupant, over two (see (*b*) for exception)	.05	
	(*b*) If milliners, tailors, dentists and similar small mercantile occupants above grade floor	.02	
	(*c*) Manufacturing or mechanical or hazardous occupancy not less than		.15
15	EXPOSURE. N. S. E. W. Deduct for exposure protection, side,		
	Total		
16	DEDUCT. For Watchman and Clock or approved equipment of Thermostats.	.10	
17	For A.D.T. System for Watchman, additional	.05	
18	For Thermostats in stores and basements only	.05	
19	For Approved Fire Extinguishers	.10	
20	For exceptional good features		
	Total		
21	FOR ELECTRICAL DEFECTS, add not less than		.25
22	For exceptional bad features, add as per rule		
	Net Flat Rate		

OCCUPANCIES			

The Analytic System. The Universal Mercantile Schedule, while still used, has been widely replaced by a system devised by A. F. Dean and known as the "Analytic System." This system, frequently referred to as the "Dean Schedule," is fundamentally different from the

Universal, yet from the insured's point of view it is similar, in that charges and credits are added to a basis rate, dependent upon the hazards brought to light by a survey.

The principal points of difference lie in the determination of the basis rate and the method of applying thereto additions and deductions for good or bad features. Instead of attempting to establish a basis rate for a standard risk in a standard city, the Dean System begins by classifying cities in accordance with the degree of fire protection and efficiency of fire-fighting facilities. Instead of the ideal standard building of the Universal Schedule, a one-story brick building of ordinary construction located in a village having no protection whatever is used as a starting point for individual rating. The use of an average type building, instead of the ideal, has the effect of making the basis rate higher to begin with, but, on the other hand, deductions and additions for different features are fewer.

The Analytic System groups cities into ten classifications, and buildings are classified according to type of construction into three groups designated A, B, and D. Fireproof buildings receive the A designation and those of brick and stone construction are in class B. Class D includes buildings of frame construction. The schedule provides construction standards for each class.

The rating bureau having jurisdiction establishes a basis rate for each particular community. The schedule provides tables for each of the three classes of construction.

From the point of view of the operation of the schedules, perhaps the outstanding difference between the Analytic and the Universal is to be found in the method of applying charges and credits. With the exception of certain after-charges for untidiness and carelessness, which represent flat sums added to the rate, all charges for other hazards deemed to be inherent in the risk are made in terms of a percentage of the basis rate. This practice is based upon certain fundamental assumptions. It is the contention of Mr. Dean that every risk absorbs the ratio of the hazards to which it is exposed and that, by the same reasoning, it transmits a ratio of absorbed hazards. Finally, the risk itself radiates hazards inherent to it. The ratio of radiated, absorbed, and transmitted exposures is modified by the structure of the building, clear space intervening, and fire department protection. Because of these assumptions that hazards are radiated, transmitted, and absorbed as ratios, adjustments are made as per-

centages rather than as flat charges. This in contrast to the Universal Mercantile System, in which flat charges are made for defects in the building as compared with standard, although certain unusual features of the building may permit a final credit in terms of percentages.

The details of the Analytic System are many, and the refinements to which the measurement of hazards have been carried make the problem of rating complicated and involved. The insured, however, is primarily interested in knowing that it is possible, through the elimination of chargeable construction defects or the installation of protective devices, to lessen materially the insurance premium for the protection he requires.

Substandard Construction. In connection with rate analysis, one of the first points in the rate structure for consideration is charges for features of construction classed as "other than standard." Here frequently the variation from the requirements may be only slight, and by means of some inexpensive modification the risk may be made standard, and a substantial saving effected.

In the case of skylights, cornices, stairs, heating, lighting, electrical wiring, and the like, slight alterations to correct defects not infrequently result in savings far in excess of a normal return on the amount invested.

Exposure Charges. In both the Universal and the Analytic system of rating, charges incorporated in the rates are dependent, among other factors, upon the construction of adjoining buildings, the distance between risks which affect each other, protection, and the hazards of the exposing risk.

If a building of superior construction is exposed on any side by a high-rated risk, it is frequently possible to eliminate the exposure charge. When a brick wall contains one or more unprotected openings, the rate may be materially lessened by entirely closing the openings when feasible, or by otherwise protecting it. Standard firedoors, standard fire shutters, wire-glass windows set in steel sash and frames all contribute to the elimination of exposure charges, and their installation frequently proves to be profitable.

Changes in Occupancy. As already stated, the rate of a particular risk is affected by the occupancy of the property. This is true as well of the occupancy of exposures. It frequently happens that a hazardous occupancy is eliminated and, through neglect or oversight, no application is made for re-rating. This is more likely to be the case

when the change of occupancy occurs in a risk, not directly under the control of the insured, but which exposes his property. Whenever the insured finds that there have been any changes in occupancy since the promulgation of his rate, in either his own or adjacent property, an investigation to ascertain their effect upon his rate is in order.

After-Charges. At the end of the schedule is provided a space for a charge for hazards growing out of faults of management. These are not inherent in the risk but are usually the outgrowth of carelessness or indifference. Since such hazards are readily corrected, a charge is made which aims to make their elimination profitable to the insured.

Charges are made for such hazards as broken plaster or windows; smokepipes improperly placed near combustible material; improper receptacles for oily waste, ashes, or cloths used for cleaning; the accumulation of rubbish; and other indications of slack housekeeping and carelessness.

If, unknown to the insured, after-charges of this sort have crept into his rate, he will find it inexpensive to correct them. Frequently when a property changes hands the new owner may of his own volition clean up conditions that carry an after-charge in the fire rate of his building. Unaware that this charge is part of the rate, he may continue to pay for the hazard through failure to notify the rating board of its removal.

The Automatic Sprinkler. Perhaps there is no single improvement to be made to a property that will to a greater degree effect a rate reduction than the installation of an automatic sprinkler system. Sprinkler systems found their first extensive use in factories but are now used in almost every type of structure. Hotels, schools, grain elevators, mills, factories, warehouses—all find it profitable to benefit by the protection afforded. In buildings where the temperature is below the freezing point of water, a dry system is available. The pipes, instead of being filled with water, contain air under pressure up to the sprinkler head. When a sprinkler head is opened, the compressed air is released, and water then flows through the system and through the opened valve to drench the fire.

Before installing a sprinkler system, the insured may obtain from the rating organization in his jurisdiction a plan and statement of the requirements as to the equipment necessary and its installation in

order to qualify for classification as a sprinklered risk. By this means, the property owner may obtain bids from contractors covering installation costs, as well as a figure representing the new rate to be promulgated when the work has been completed.

The cost of sprinkler installation is considerable. There are certain minimum requirements that make the charge seem unreasonably high for risks involving small values. When values are under $50,000, there is little incentive for the installation of a sprinkler system, unless considerations other than rate reductions predominate. When large values are involved, it is usually found that over a term of years the savings on the insurance premium will pay for the sprinkler system. The capital investment having been returned in the form of premium reductions, the saving then continues as a gain for the property owner.

Other Protective Devices. Credits on the rate are allowed for protective features less elaborate and complete than the automatic sprinkler system, nevertheless designed to minimize the risk. Among these may be mentioned approved fire extinguishers, automatic thermostatic fire alarms, watchman service, fire pails, and standpipe equipment.

When the installation of this type of equipment is contemplated, care should be exercised to see that it meets the standard of rating requirements. Considerable money might be spent for equipment which would receive no credit on the rate, because of failure to meet the required specifications. A slight rearrangement of the equipment, or some additional equipment, may make the required difference.

The same rule applies in connection with present installations. A property owner might install fire extinguishers for his own protection in a haphazard manner which seems to him to be suitable. To secure a rate credit, he may, however, need a few more extinguishers or a better distribution of those already installed. The expense of such readjustments of protective features to comply with requirements for a rate credit is frequently negligible.

Rates and Planning. When plans are being approved for new construction, before final acceptance their submission to the rating organization ultimately destined to rate the building will frequently bring forth suggestions to increase the safety of the property and lessen the insurance cost. A slight addition to the thickness of a wall,

change in roof specifications, an increase in the thickness of a floor, changes in floor openings, elevators, vents, light shafts—all may be most profitable investments in the light of the return in the saving of insurance premium.

While much may be done in the way of correction after a building is completed, obviously when, with a few strokes of the architect's pencil, corrections may be made in the drawings to eliminate chargeable hazards, the planning stage is the point at which to catch and eliminate the defect. Moreover, at this stage defects can, at a very small cost or even at no extra cost, be eliminated that, because of expense, would be beyond consideration in a completed building. Such a change might be the substitution of metal stud and lathing for wood. Obviously, after the building is completed such a change is out of the question. Through submission of the plans and specifications to the rating bureau, a complete rate analysis may be obtained for study before final acceptance and approval of the plans.

Other Benefits. In connection with this discussion of rates, emphasis has been placed upon the money saving to be effected by the correction of hazards. It is to be emphasized that this is but one benefit, and perhaps the least important of a number. The owner of a building, stock, or business purchases insurance to indemnify himself in the event of loss. In spite of adequate insurance protection, and frequently the insurance is less than adequate, the insured will suffer various consequential losses in the event of fire. He is therefore interested in taking steps to minimize so far as possible all known hazards, with a view to increasing the safety of his property, entirely apart from the saving in insurance premium. It is held to be better to spend money to prevent a loss than to spend money to be indemnified in the event of a loss. The money spent for indemnity is justified on the ground that, after every reasonable means to effect safety has been adopted, there is still a risk that can only be handled by means of insurance.

A second advantage is to be found in the ability to secure insurance to value. A hazardous risk is written with caution by insurance companies, and when large values are involved it is not always easy to obtain full insurance. When major hazards have been eliminated or reduced to a minimum, the securing of adequate insurance protection is no longer the same problem.

Rating Bureaus. The work of rating is placed in the hands of

specialized rating bureaus. Headquarters for the various organizations are located at strategic points throughout the country. Jurisdiction over a specific territory is assigned each organization, and branch offices sufficient to meet the territory's needs are located in the important congested areas. There are about forty such organizations handling the problems of fire rating in this country.

It is the function of the rating bureau to apply the schedule in use in the territory to each property that is the subject of insurance. The task is large, and to accomplish it requires a huge staff of inspectors, engineers, and scores of experts highly trained in specialized fields. Rate manuals and tariffs are published, and corrections are furnished from time to time to insurance companies and their representatives.

Application for a new rate, or for re-rating a building already rated, may be filed with the rating organization either by the owner of the property or by an insurance agency or company interested as an insurer.

FOR REVIEW

1. The X department store has recently installed a department carrying furs. A large part of the stock is stored in a fireproof vault. The store covers its stock under one form with a 90 per cent coinsurance clause. Recommend a change.
2. The Factory Mutuals are a group of insurance companies writing insurance under mutual basis upon selected risks. Have the stock companies facilities for competing with the Factory Mutuals?
3. What is an average rate and how is it found?
4. The X manufacturing company stores its finished product in four warehouses with rates in each instance of 1 per cent. Due to the need for additional space, a fifth warehouse is leased. Due to an unfavorable exposure the rate is 2½ per cent. Advise this insured in the matter of handling his stock.
5. X, the owner of an apartment house, carries $50,000 insurance with an 80 per cent coinsurance clause covering on the building. He insures the contents belonging to him on a specific policy. The policy covers contents, consisting principally of floor coverings, refrigerators, stoves, fuel, janitor's equipment, and the like. Recommend an alternative coverage that will be less expensive.
6. The B high school has an insurable value of $1,000,000; insurance in the amount of $800,000 is carried. In the auditorium is a moving picture booth. Because of failure to provide automatic closing devices in the event of fire for all openings, a charge of 5 cents is added to the rate. How much could the insured afford to pay to install the automatic closing devices?
7. A brick warehouse is located adjacent to a dilapidated wooden structure,

and the owner accordingly finds an exposure charge in the rate. He has no control over the adjacent hazard. Is there any way he may reduce or eliminate the exposure charge?

8. X has installed a large number of fire extinguishers in his plant. Inquiry reveals that he is receiving no credit therefor in his fire rate, while Y, with a similar plant, enjoys a substantial reduction in rate. Can you advise X?
9. The Gem Theater has just been completed, and application for fire rate filed. It is now discovered that a substantial charge is included in the rate because the building was constructed with wooden laths. Wherein did the owners fail concerning this rate?
10. You are the City Manager of X city. It has been brought to your attention that the janitor of the high school has fastened back the fireproof doors leading to the stair wells. Will this affect the fire rate and why?
11. X is building a new building and finds, upon inquiry, that no insurance rate for the finished building has been promulgated. He wishes, however, to write insurance on the property at once. How can this be done?

CHAPTER XIX

LOSS AND ADJUSTMENT

REQUIREMENTS of the Insured. The purpose of the insurance contract is to provide indemnity for losses sustained, but as a contract it imposes obligations upon the insured as well as upon the insurance carrier. Certain very definite obligations develop immediately upon the occurrence of the loss.[1] Two of these, the requirement of the notice of the fire and the obligation to file a proof of loss, are conditions with which the insured must comply before there is any liability on the part of the company. The insured is obligated to take the first step, and until he does so there is no requirement on the part of the company to effect an adjustment. Aside from the obligation to take all necessary steps to protect the property from further damage, the other requirements demand no action on the part of the insured unless a request for compliance originates with the insurer.

Notice of Loss. The purpose of notice to the company is to convey the information that a loss, in which it has an interest, has oc-

[1] These obligations are set forth in the standard policy as follows: "The insured shall give immediate written notice to this Company of any loss, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, showing in detail quantities, costs, actual cash value and amount of loss claimed; **and within sixty days after the loss, unless such time is extended in writing by this Company, the insured shall render to this Company a proof of loss,** signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: the time and origin of the loss, the interest of the insured and of all others in the property, the actual cash value of each item thereof and the amount of loss thereto, all encumbrances thereon, all other contracts of insurance, whether valid or not, covering any of said property, any changes in the title, use, occupation, location, possession or exposures of said property since the issuing of this policy, by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of loss and whether or not it then stood on leased ground, and shall furnish a copy of all the descriptions and schedules in all policies and, if required, verified plans and specifications of any building, fixtures or machinery destroyed or damaged. The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same; and, as often as may be reasonably required, shall produce for examination all books of account, bills, invoices and other vouchers, or certified copies thereof if originals be lost, at such reasonable time and place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made."

curred, so that it may take whatever steps it deems necessary to safeguard its interest. Obviously, any unreasonable delay in notice might hamper investigations or otherwise injure the position of the company.

What constitutes immediate notice is subject to interpretation and is dependent upon circumstances surrounding every case. If the insured exercises due diligence and forwards the notice without unnecessary delay, the company will take into consideration the situation of the insured and all the circumstances with which he is surrounded and consider this to be sufficient compliance. What constitutes reasonable diligence is entirely a matter of circumstance. If there is no reason to prevent, notice should be given the day the loss occurs, or at least the day following.[2]

The Proof of Loss. The condition of the policy requiring the insured to render within sixty days, unless the time is extended in writing, a statement in which is incorporated certain information deemed essential is the second obligation placed upon the insured as a condition precedent to recovery under his policy. This information has to do with the knowledge and belief of the insured as to the time and origin of the fire, title to the property, cash value of each item and the amount of loss thereon, encumbrances, other insurance, and the like. The document thus required is termed in the insurance field the "proof of loss." The proof of loss, unless waived, must be furnished within the time required by the policy.[3] The policy requires that the statement be furnished to the company. If the proof is given to the duly authorized agent of the company within the prescribed time limit, the requirement has been complied with. Blank forms designed to meet the requirements of the insurance company in the matter of the proof of loss are obtainable, and their use to a considerable degree lessens the possibility of a technical error or deficiency.

Proof a Problem of Values. The proof of loss is a statement of

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[2] In a New York case, the policy was in a safe in the building that was burned and could not be obtained until about the time notice was given, fifty-three days after the fire; and notice was held sufficient. In another case, a notice given fourteen days after the fire, unaccompanied by any fact or circumstance excusing the delay, was held not to be immediate notice.

[3] It has been held that the sixty-day period begins to run from the termination of the fire, not from its beginning, but the requirement that proofs be furnished within sixty days after the fire is not complied with if proofs are deposited in the mail on the sixtieth day and do not reach the company until the sixty-second day. There is no specific requirement as to where the proofs shall be filed.

fact concerning the property, the loss, and the insurance. It has for its purpose the supplying of information as a basis of settlement. Information necessary to indicate compliance or noncompliance with the policy terms and conditions is supplied. If this information is found to be satisfactory, concern is then with values, a point of the utmost importance to all parties to the contract. The insurer is obligated to indemnify the insured to the extent of the actual cash value of the property destroyed or damaged, with deductions for depreciations, and with a limit fixed by the cost of repairing or replacing the destroyed or damaged property within a reasonable time with material of like kind and quality. The obligation to pay the loss rests upon the company. The obligation to prove the loss rests upon the insured. The essential element in proving the loss is to be found in the ability to demonstrate the values of the property.

When Loss Is Partial. A misconception which may lead an insured into difficulty is found in the idea that after a fire, the damaged property should not be touched until examined by the fire insurance adjusters. The insured is under no obligation to leave the property undisturbed; on the contrary, he is definitely required to do everything reasonable to prevent further damage. An insured who fails to protect his property adequately from further loss after the fire cannot collect for the additional loss thus occasioned, and it has been held that where there is a willful failure to protect property from further damage the insured can collect nothing under the policy.

When the damaged goods have been segregated, the insured is required to make a complete inventory, stating the quantity and cost of each article and the amount claimed as a loss. If the goods are totally destroyed, an itemized inventory is not required. The inventory, if obtainable, is used as a basis for determining value and simplifies the problem of determining the loss.

The next step is to determine the amounts and quantities involved in the loss. If the goods destroyed were purchased by the insured in the open market, there is usually an established market value, and the quotations on the day of the fire, plus freight and handling charges, less discounts, form the basis of the valuation for adjustment purposes. If the insured is not entitled to claim market value, as in the case of a manufacturer, the acquisition cost must serve as a basis, to which is added appreciation to cover any increased cost of manufacture, or from which is subtracted depreciation if costs have de-

creased. Another element of depreciation must be considered—whether the valuation basis be market quotations or acquisition costs. Any stock merchandise on the shelves of a business organization will, as a matter of course, have a valuation less than that of new merchandise. This grows out of changing styles, seasonal demand, broken lots, odd and irregular sizes, breakage, shopwear, and deterioration of every sort. This element of depreciation is absorbed as an expense of the business, but is present and must be considered in unsold goods.

When once the satisfactory valuation has been obtained and the element of loss computed, the figures thus obtained will serve as the basis for settlement. The representatives of the company and the insured will verify the figures and undertake to reach an agreement as to the amount of the loss and damage. In the event an agreement cannot be reached, provision is made in the policy for an appraisal, which either party may demand, and when so demanded by the insurer compliance is a condition precedent to the right of recovery.

The Appraisal. In the adjustment of losses the element of judgment plays an extremely important part. Aside from those cases in which the honest intent of one or the other of the parties may be questioned, there are innumerable instances in which an honest difference of opinion results in a disagreement as to the amount of loss or damage. The framers of the standard policy, in the light of their experience, foresaw the frequency of disagreement growing out of errors of judgment or insufficient information, on the part of one or both parties to the contract, and undertook to avoid court action as far as possible. To expedite settlement, in case the insured and company shall fail to agree, provision is made to submit the loss to appraisers. The method of selecting appraisers is set forth in the policy.[4]

When an appraisal is conducted in due compliance with the policy

[4] To expedite settlement the following clause was incorporated in the policy: "In case the insured and this Company shall fail to agree as to the amount of loss or damage, each shall, on the written demand of either, select a competent and disinterested appraiser. The appraisers shall first select a competent and disinterested umpire; and failing for fifteen days to agree upon such umpire then, on the request of the insured or this Company, such umpire shall be selected by a judge of a court of record in the state in which the property insured is located. The appraisers shall then appraise the loss and damage stating separately sound value and loss or damage to each item; and failing to agree, shall submit their differences only to the umpire. An award in writing, so itemized, of any two when filed with this Company shall determine the amount of sound value and loss or damage. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally."

requirements, the award determines the amount of the loss and damage. The finding is conclusive, and from it neither party can appeal, except on the ground of irregularity in the appraisal. The determination of the loss and damage is taken out of the hands of both insurer and insured, and both are equally bound by the results of the appraisal.

While either party to the agreement may demand an appraisal, there is no obligation for compliance until there has been an actual disagreement. The powers of appraisers are broad, and the insured may prefer to keep the matter of the judgment in his own hands. The company may likewise prefer, if possible, to handle the claim itself. There must, therefore, be an actual effort to agree, and not until this effort fails has either party the right to demand an appraisal. There can be no disagreement and no points of difference to arbitrate until an attempted agreement has failed.

Awards signed by two or by three of the appraisers determine the amount of the loss. This amount cannot be set aside, except for fraud or corrupt practices involving one or more of the appraisers or for mistake or willful misconduct on the part of the appraisers. The burden of proof rests with the party seeking to set aside the findings of the appraisal, and unless there is clear and strong evidence of partiality, conspiracy, fraud, or palpable error, the presumption is in favor of fairness. If an award is so far out of line with the facts as to shock the moral sense, that is held to be sufficient evidence to submit in connection with charges of fraud, corruption, partiality, or bias; and the finding may be set aside whether the inadequacy is the outgrowth of fraud or mistake.

Suit. When an insured has complied with all the conditions and requirements of his policy and still fails to effect a settlement, he may then have recourse to the courts. In order that questions of liability may not accumulate against insurers and be revived at indefinite dates, the policy sets a limit within which suit must be filed. The policy provides: "No suit or action on this policy, for the recovery of any claim, shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, nor unless commenced within twelve months next after the fire." In states where the New York standard form has not been adopted, reference to the standard policy of the state will indicate where the time limit differs.

Total Stock Losses. In the event of a total loss of the stock, when the fire is of a nature to burn the goods "out of sight," the problem presented is quite different. A physical inventory is, of course, impossible. The value of the destroyed property must be determined by an entirely different procedure.

This is accomplished through recourse to the books and accounts of the insured. If the books are properly kept, inventories accurately taken at stated periods with all items carefully recorded at original cost, and a record kept of additions as made and of the income from sales, it is comparatively simple to compute the value of goods on hand at the time of the fire.

To accomplish this, one must take an inventory as a starting point, add to this, purchases made, and deduct sales. Since the record of purchases is made on the basis of cost, and sales income is recorded on the basis of selling price, to arrive at the value of the goods on hand it is essential to reduce the item of income from sales to a figure that will represent the cost of the items sold, and not the selling price. To do this, it is essential that one know the margin of profit. The gross mark-up will not furnish this figure. It is obtained by finding the cost of merchandise sold during a period of a year and subtracting this figure from the income from sales for a year. This difference will be the profit for the year. Reducing the figure representing profit to a percentage of sales, one may then use this percentage figure to determine the cost of goods sold.

When the margin of profit has been determined, it is a matter of simple addition and subtraction to arrive at the value of the inventory when the fire occurred, and hence the amount of the loss.[5] The

[5] When the figure representing the value of the stock at the time of the fire is found, adjusters are sometimes inclined to term this figure "cost" instead of "value." Assuming the figure to represent cost, they feel that to arrive at the fair value, or amount of the loss, they themselves should be entitled to a further discount for depreciation. The error of this calculation is to be seen when it is realized that shrinkage, breakage, and other depreciation items are absorbed in the margin of profit. When a margin of profit is computed for the entire year, the depreciation for the entire year is incorporated in that figure. When to arrive at the loss figure, the computation starts with a depreciated inventory, and when purchases are reduced by applying a margin of profit to every item purchased and that margin includes a proportionate factor of depreciation, there is a running depreciation applied to all purchases, and the figure marked "value of stock" represents a depreciated figure; hence, to add further depreciation would be to work an injustice to the insured. It would be, in fact, depreciating an already depreciated figure.

Again, if the items of freight and discounts are ignored in the inventory, these items must be counted into the computation of the loss. Freight and handling charges are

method of determining value of inventory follows:

STATEMENT OF LOSS

Inventory of stock on hand at beginning of year (cost) . . . . . $
Adjustment for depreciation . . . . . $_____
Actual value of stock at beginning of year . . . . . $
Subsequent purchases . . . . . $_____
TOTAL goods to be accounted for . . . . . $
Sales . . . . . $
Less profit (%) . . . . . $_____
Cost of goods sold . . . . . $ Deduct . . . . . $_____
Value of stock on hand at time of fire . . . . . .

Fixed Capital. The problem of determining value, and loss or damage in the case of stock or merchandise is considerably simpler than that presented when the subject of the loss is machinery or buildings. Merchandise, or stock in process of manufacturing, represents consumers' goods, and accordingly its life in the normal course covers a comparatively short span. Values are a matter of market quotations or manufacturing costs, which are readily available from a proper set of records. The problem of depreciation is not complicated. In the case of fixed capital, or producers' goods, as, for example, machinery and buildings designed for use over a long period of years, the problems of depreciation and obsolescence become factors of major importance. The solution of the difficulties they present are by no means as simple as accounting practice would indicate.

In relation to a fixed asset, depreciation has been defined as the inevitable decrease in value resulting from wear, tear, and the lapse of time. When the decrease in value is the outgrowth of an improvement in a manufacturing process or a discontinuance in the demand for the product manufactured, the loss is due to obsolescence. Depreciation and obsolescence do not run parallel, and arbitrary charge-offs on the straight-line basis may result in a conservative capital account, but it certainly offers no accurate measure of the value.

It can readily be seen, for example, that a property built during a period of low construction costs might actually be growing more valuable each year as building costs advance, yet a straight-line depreciation of some arbitrary percentage, say 5 per cent, would furnish a book value of less than cost, whereas the actual value would be greater. The same situation might exist with regard to an expensive machine. The invention of a new process or a substitute product might, how-

properly added to the value of the goods, and from this figure are to be subtracted all discounts. Sometimes a balance between the two is taken and credited or charged, according to whichever is the greater.

ever, in the meantime have made the machine valueless, or virtually so.

Because of the difficulties involved in fixing a value in the case of fixed capital for the purposes of an insurance adjustment, it is as essential that a satisfactory and competent appraisal be available as a point of departure, as it is that the coverage be adequate. The insured understands that he must pay substantial sums annually for his insurance protection. He should likewise understand that the cost of an adequate appraisal is a proper charge when the placing of insurance is carried on in an efficient and business-like manner.

Machinery Losses. In the adjustment of machinery losses, an accurate appraisal within a reasonable period is essential for satisfactory results, unless the cost, description, and subsequent history of replacement and repair are available in complete form.

The problem of depreciation and obsolescence is one of great importance. A machine may be practically new, but because of an invention or change in process the machine may become almost valueless, as, for an example, when a steam plant with belts and shafts is replaced with electrical machinery. Each machine has its individual motor, and shafts and belts that cost thousands of dollars become mere junk, with a negligible salvage value. So with the advent of high-speed steel, great values in machine tools were wiped out in a single stroke. With the invention of the propeller for steamships, millions of dollars in shipping values disappeared through obsolescence. In the case of machinery, this element can operate to obliterate value completely, or nearly so, in a very brief time.

Physical depreciation likewise warrants special consideration. The parts of a machine deteriorate at different rates, and to estimate depreciation from this source with any degree of accuracy it is necessary to break the machine into its composite units. There are parts of a given machine that are practically indestructible, while other parts may have a life of but a few years or very much less.

Partial Building Losses. In the event of partial destruction of a building, the customary procedure in effecting an adjustment is to obtain from a reliable contractor or builder an estimate of the cost to repair and replace the damaged property. Frequently, a builder representing the insured and another representing the insurer work together in making the estimate of loss. They proceed together, calculating costs, item by item, and agreeing as far as possible whenever a

discrepancy occurs in their estimates. About most losses figured by two experienced, responsible, and fair-minded builders, there is little trouble in agreeing. When there are points of difference, these can be referred to the interested parties, and usually an agreement can be reached. The findings of the builders are without legal effect and are for the purpose of information only. If the insurer and insured cannot effect a settlement, the only recourse is to a formal appraisal, which in operation applies exactly in the same way to building losses as to stock.

Failure to agree in the case of partial building losses is frequently due to a misunderstanding on the part of the insured as to his coverage. Frequently claims are made for items not properly to be included in the estimate of damage. Changes in construction requirements due to building ordinances, making replacement cost more than the cost of the damaged parts, will not permit a claim for the extra cost without the demolition clause. Nor does the policy undertake to replace old with new. Depreciation is, therefore, to be deducted from the replacement figure, though this need not be at a flat rate. Different parts of the building will be subjected to different depreciation figures, depending upon the state of repair. For example, if a house had been painted a week before a fire, but its wooden shingles are twenty years old, and both paint and shingles are damaged, obviously no depreciation will be charged in the paint item, but the figure will be heavy in the shingle item. Architect's fees do not represent a proper claim in minor losses. When, however, the damage is such as to necessitate the employment of an architect before necessary repairs can be made, the fee represents part of the cost to repair or replace and may properly be included in the computation of the loss. Questions concerning liability or the extent of the coverage are not properly submitted to an appraisal. The function of the appraisal, as defined in the policy, is to adjust disagreements when the question involves loss or damage. All other questions, including liability, must be settled by the parties or, if they fail, by the courts.

Total Loss of Buildings. When an adequate appraisal of buildings has been made by competent appraisers and has subsequently been kept up-to-date by applying to the component parts a factor representing changes in construction costs and applying the proper depreciation figure to the present replacement cost, the problem of sound value, hence of loss, is not a difficult one.

When no appraisal has been made, some starting point must be found. A set of blue prints covering building plans, with the date of construction, furnishes such a point. This, however, is frequently not available, and the search for data must proceed further. The date of the construction itself is a starting point, but even that is not always available. Many plant accounts fail to furnish these data, as well as reliable information concerning dates of subsequent replacements or additions. An inquiry among older residents of the vicinity, a study of newspaper files, building permits, and, when pertinent, the record of property transfers will generally serve to fix the date of construction, which in turn serves to fix the depreciation when the replacement cost has been found.

Two methods are advocated for fixing value in the instance of the total destruction of the property when neither appraisal nor plans are available as a guide. The first of these is the "discount method." This is based upon computing future earnings on the basis of past experience. Value is found by a process of discounting. This process establishes land valuation by comparison, and the value of the building is determined by discounting that portion of the income which remains after deducting land returns. This process is followed because land is a permanent investment, but the buildings have a measurable usefulness. In applying a discount factor to the income from buildings, this is computed on a basis that gives recognition to the estimated economic life. The second method is known as the "square-foot method." This method is based upon the assumption that if a given building of a known type and construction costs a certain sum, its cost may be reduced to a square-foot basis, and the unit thus obtained may be applied to measure the value of other buildings of like construction. Both methods are faulty. The second comes nearer to a basis of sound value than the first, but only when the figure obtained is modified to fit peculiarities of construction in the nature of variations from the standard used as a base. The discounting method is subject to such wide variations because of the factor of personal judgment that when useful at all it serves as a check on the square foot method.

When an accurate appraisal is made within a reasonable time or when the date and cost of construction are known, values may be brought up-to-date with a table of price index trends. The table is computed with reference to a base year, and relative costs for any

year may be found. When the present replacement value of the building is found by means of the table, it is then depreciated to compensate for its age.

Options of the Company. The fire insurance contract provides for two modes of settlement. The first is the payment of damages for the loss, and the second is the restoration of the subject matter of the insurance to its former condition.[6]

If a company feels that it may rebuild the damaged property to its own advantage rather than make a payment for damages, it may elect to do so. If the insurer elects to rebuild, he is held to have abandoned the alternative mode of settlement, and the insurance contract is at once converted into a building contract. The amount of damage recoverable for a breach is not thereafter limited to the amount of insurance. When the insurer elects to rebuild, he must complete the operation, and he is liable for damages, including rent, resulting through delay. When separate insurers elect to rebuild, in case of breach, it has been held that the owner may proceed against one of the insurers and collect full damages, leaving this company to seek contribution on its own account from the others.

The option to repair or replace involves the insurance carrier in the business of building construction, and the liabilities incurred make choice of rebuilding most unattractive. It is not at all the common procedure to exercise this option, and companies prefer, when at all possible, to settle all losses by a cash payment.

In the case of stock, the insurer may sometimes settle a troublesome loss by agreeing upon the sound value of the damaged stock and then turning the damaged items over to a salvage company to be sold. The amount realized is credited to the insurance companies, who in turn pay the insured a total loss. It must be recognized, however, that the insured has no right to ask the company to take the property and salvage it. The policy specifically covers the point by stating that there can be no abandonment to the company of the property. When, however, the appraisal indicates a loss with a salvage less than the company believes it can realize, it may on its own account exercise

[6] The restoration privileges of the insurer are stated in the following clause: "It shall be optional with this Company to take all, or any part, of the property at the agreed or appraised value, and also to repair, rebuild or replace the property destroyed or damaged with other of like kind and quality within a reasonable time, on giving notice of its intention so to do within thirty days after the receipt of the proof of loss herein required."

the option to take all or part of the goods at the appraised value.

While it has been held that when an insured sells goods without giving the company the right to exercise the option to take the goods, he renders his policy void, it has likewise been held that after an appraisal the company must take some steps to indicate its intention to exercise the option before it can claim breach of condition, and that to ask the insured to keep the goods thirty days, while awaiting the company to indicate its intention, is unreasonable.

Contribution. The policy provides that each company covering on a risk shall pay for losses on a pro rata basis, the limit of liability being, of course, the face of the policy. In this connection the policy states: "This Company shall not be liable for a greater proportion of any loss or damage than the amount hereby insured shall bear to the whole insurance covering the property, whether valid or not and whether collectible or not." In order to contribute in the event of a loss, the various policies must cover the same interest. One set of policies covering an owner, and another set a mortgagee, do not contribute because the interests covered are not identical.

The reference to the validity and collectibility of the insurance has the effect of placing the responsibility of selecting the insurers upon the insured. If, in the event of the insolvency of a part of the insurers, the others had to bear the loss until the insurance was exhausted, the strong companies would be in the position of being forced to settle losses for which the weak or insolvent companies had been paid a premium.

Insurance that is absolutely void is not contributing insurance. If a policy has been canceled, it is no longer "other insurance" and cannot, therefore, be brought in for contribution, with the result of reducing the insured's claim against the solvent and effective insurance. The effect of the cancellation is the same, whether it be by agreement or by operation of the law.

Apportionment. The effect of the policy provision for pro rata liability of all companies covering a given interest is at once apparent. If a loss of $1,000 occurs in the case of ten $1,000 policies covering on a risk, each policy will contribute one-tenth, or $100. Now assume that the loss is adjusted and that the insured finds himself unable to collect from one company because it is insolvent. He still has, however, $9,000 of collectible insurance. Will the nine companies pay the $1,000 loss? Not at all. Their liability remains the same, and

though the insured has $10,000 insurance, $9,000 of which is solvent, he can collect but $900.

The apportionment is a matter of simple arithmetic. Sometimes when the policies are for odd amounts, as when they are reduced by the payment of a loss and not reinstated, the apportionment assumes an involved appearance.

An apportionment is ordinarily stated as follows:

Loss $4,000
Insurance $8,000

Company	Insures	Pays
A	$1,000	$ 500
B	2,000	1,000
C	3,000	1,500
D	2,000	1,000
Total		$4,000

Coinsurance Nonconcurrence. When a number of policies cover on a given risk and part are written flat, the remainder carrying a coinsurance clause, the question of apportionment is sometimes perplexing. For example, if an insured has a $10,000 value and carries $4,000 insurance in four companies, written each with a face of $1,000, a loss of $2,000 is paid without question if the policies are written flat. Likewise, if the total insurance is $2,000, a loss of $2,000 is paid in full under flat insurance. In the foregoing case, if $2,000 is written flat and $2,000 written with the 80 per cent reduced rate contribution clause, the situation changes. In the case of the policies bearing the coinsurance clause there is no question; the limit of their liability is governed by the coinsurance clause. Since the insured is carrying only half the amount required in order not to be made a coinsurer, the policies carrying the coinsurance clause will pay but one-half the loss they would have paid if written flat. Hence, the $2,000 policies written with the 80 per cent clause will pay but $500 of the loss, leaving $1,500 to be accounted for by the flat insurance. But since, under the terms of the policy, the flat insurance is liable for no greater proportion of any loss or damage than the amount insured shall bear to the whole insurance covering the property, whether collectible or not, it therefore follows that the flat insurance, though covering for $2,000, is liable only for the full amount that it would have paid if all the insurance were flat, that is, $1,000. The courts have held that such loss as the insured bears under one policy

by reason of the operation of the coinsurance clause cannot be added to the liability of companies whose policies contain no such agreement, that is, companies whose policies are written flat.

Fire Insurance Adjusters. Since the fire insurance policy is a contract whose terms and conditions are carefully stated, in the event of a loss the insured has his contract to follow in effecting an adjustment. As a matter of practice, a company representative approaches the insured and, if investigation shows the loss to be legitimate, undertakes to effect a settlement, sparing the insured as much technical detail as possible.

Local agents are usually authorized to settle and sometimes to pay small losses. When a loss exceeds the limit of the agent's authority, he reports the claim to the company, and an adjuster is designated to handle the settlement. Adjusters fall into three categories. They are: (1) company representatives, (2) independent adjusters, and (3) company-owned bureaus.

The contract between local agents of fire companies and the home office is maintained through a field man, known as a "special agent," "state agent," or "general agent." Among other functions, the field man has jurisdiction over loss adjustments. When a great many companies are interested in a single loss, the company writing the largest amount of the business is said to have the "top line" and is expected to look after the details of the adjustment. It is usual to form a committee of three or more adjusters and to turn the loss for all companies over to the committee, though any field man interested is permitted to sit in on the settlement. It is the usual procedure for all companies to follow the recommendation of the committee. If only one company is interested in the loss, the field man may handle it himself, or he may designate someone else to do the work.

Independent adjusters are experts who have made loss-adjusting a business. Some have specialized in particular fields, and they are called upon when technical skill of a particular nature is required. Others in the field possess a general knowledge and understanding of adjustment procedure and handle losses when it is impossible or inconvenient for the company representative to give prompt attention.

Adjustment bureaus are becoming, more and more, factors in the field of loss adjustment. These bureaus have numerous branches. Their sole business is loss adjustment and they are owned through stock distribution by the fire insurance companies. The bureaus are

not organized for profit, and an effort is made to adjust charges to meet expenses. If a profit is earned, it is distributed in due course, but if there is a deficit, this is met by assessment. Bureau adjusters are highly trained and experienced men who devote their entire time to adjusting losses. Companies look with favor upon the trend toward bureau adjustment, feeling that it tends to an equitable treatment of all members of a community and eliminates competition among adjusters and agents in the matter of building a reputation for generosity over their competitors by excessive claim payments. Bureau adjusters, being company representatives, are interested in the production end of the business. In the general interest of the business it is their aim to effect a prompt and satisfactory adjustment with a minimum of controversy or litigation; and, on the other hand, they are equipped to cope with fraud or false claims.

FOR REVIEW

1. After a fire in the plant of X, the insured telephones his agent, notifying him of the loss. Does this comply with the requirements of the New York standard policy?
2. A conflagration destroying a greater part of a city burned for several days. Does it meet with the requirements of the policy that proofs of loss must be furnished within sixty days after the fire, if the time is computed from the termination of the fire?
3. May an insured assume that he has complied with the sixty-day requirement as to proofs of loss if he deposits the proofs in the mail the sixtieth day after the loss?
4. In preparing proofs of loss, copies of the totals from two pages of the inventory are added twice. This swells the valuation claimed for goods destroyed by $6,000. The insurance company, upon discovering the error, contends the policy to be voided on the ground of false swearing and fraud. In your opinion is the policy voided?
5. X is an insured who has the reputation of being a sharp trader and difficult to deal with in loss adjustments. B is assigned to adjust a loss and asks immediately that it be referred to appraisers. May he insist that the loss be referred to arbitration?
6. The merchandise of Y is partially destroyed by fire. After a disagreement, the loss is referred to appraisers. After they have examined the property in question, but before they submit their figures, Y dies, and the executor of his estate, upon learning of the findings of the appraisers, contends that not having been a party to the loss adjustment up to this point the estate is not bound. What is your opinion?
7. After a loss involving a partial damage to a stock of merchandise, the insured and the adjusters fail utterly to reach any agreement. After some days

of negotiating it becomes clear that the parties will never be able to get together on an agreement. The insured asks for an appraisal and the adjuster for the company refuses. May the insured now bring suit? Prior to the suit, may the insurance company reverse itself and demand an appraisal?

8. X purchased a building for which he paid $2,000. He insured it for $5,000, and upon its destruction by fire filed proofs of loss for this amount. Investigation proved the real value to be $2,000. How much may the insured collect?
9. D, the owner of a retail store, is in New York the night his store is destroyed by fire. During the fire, a member of his family saves twenty fur coats valued at $300 each. The insured does not know the coats have been saved and files proofs swearing to a total loss. He is later questioned regarding the possibility of any merchandise being saved and makes a statement under oath that the entire stock was destroyed. Does this misstatement void the policy?
10. All the buildings on the campus of a college are covered by a schedule policy. The total amount of insurance in force is $12,744,000. The insurance is written in four companies on a three-year basis so that one policy expires each year. Because of this, each company has three policies in force. Company F covers for $2,161,500; $1,906,000; and $1,000,000. Company G covers $1,028,500; $1,936,000; and $2,138,000. Company N covers $58,000; $93,000; and $110,000. Company S covers $1,000,000; $313,000; and $1,000,000. One of the buildings is insured on the schedule for $38,000 with $1,500 on contents. A loss on the building develops, and it is agreed between the adjusters and owners that it will cost $70,535.50 to replace the damage. It is also agreed that the damage to contents is $4,342.61. The depreciation on the replacement cost of damage to building is agreed upon as $31,065.97. The agreed sound value is $51,921.93, and both building and contents are written with an 80 per cent coinsurance clause. From the foregoing information set up the amount each insurance company will pay indicating the amount chargeable to each policy.
11. On the same campus, to which reference was made in Question 10, the chapel was totally destroyed by fire. Insurance carried on the chapel building was $27,000. Insurance carried on the contents was $7,000. The sound value of the contents was $8,000. Cost to repair the building was agreed upon between the adjusters and owners as follows: roof frame $2,633; strapping $68; boarding $640; roofing $1,400; repairs to tower $700; floors $1,980; plastering $3,200; cornice $468; outside cornice $150; millwork $1,700; painting $3,500; demolition $900; miscellaneous repairs to outside wall frame $150; electrical work $1,350; plumbing and heating $100; nails and rough hardware $200; altar $1,200; built-in vestment case $550. The labor item of $3,491 was agreed upon, together with insurance during construction of $349. Overhead, social security, etc., was figured at 8 per cent. A profit item for the contractor was figured at 10 per cent. A built-in organ was valued at $10,000, and loss in the full amount was allowed. The depreciation agreed upon was $3,584. The loss to the contents was agreed upon as $6,211. Compute the loss, and draw up an apportionment of the insurance.

12. A warehouse with contents insured for $25,000 is totally destroyed by fire. In the process of the adjustment, inventory, at cost, is found to be $98,885.24. Purchases, since the inventory was taken, amount to $13,141.33. An item including discounts, return, and depreciation is agreed upon at $250.60. Goods, charged out to fifteen branch stores at cost, amount to $7,775,97; salvage, agreed figure, $7,966.15. Compute the loss and damage.
13. In the foregoing question assume flat insurance. There are nine companies covering: Company A for $2,000; Company B, $5,000; Company C, $2,000; Company D, $2,000; Company E, $5,000; Company F, $2,000; Company G, $1,000; Company H, $2,000; Company I, $5,000. Make up an apportionment showing the amount each company pays.
14. In the foregoing question assume the insurance to have been written with an 80 per cent coinsurance clause. What would the companies pay? Assume $21,000 insurance. How much of the loss would the insured collect? Assume $42,000 insurance. In this instance how much of the loss would the insured collect?
15. With all the values the same as in the foregoing question, assume a $2,000 loss with $21,000 insurance, and again a $2,000 loss with $42,000 insurance, written in both instances with an 80 per cent coinsurance clause. How much would the companies pay?
16. The contents of a retail store has a sound value of $34,521.07. A loss develops in the amount of $31,583.07 on merchandise and $1,576 on furniture and fixtures. There is in effect insurance in the amount of $20,500. The insurance is written with a 90 per cent coinsurance clause. How much of the loss will the insurance companies pay, and how much of the loss must be carried as uninsured?
17. At the time of a loss the proprietor of X grocery has a stock on hand based upon his inventory of $30,200.18. Purchases since inventory show a figure of $96,061.45. Transfers from warehouse to stock show an item of $14,518.30. Transfers out of stock to warehouse show $22,902.68; sales at cost $76,662.53. After a severe fire there is salvaged a part of the merchandise showing an inventory cost of $28,870.87. There is a fire damage to the salvaged items of $12,368.27. The cost of salvaging these items is $2,390.51. In the case of the furniture and fixtures there is an agreed value at the time of the loss of $4,373.32, with an agreed salvage of $1,755. In a separate inventory a wine stock is carried showing $5,381.21; purchases since inventory amount to $4,626; transfers from warehouse to stock amount to $1,313.22; sales at cost since inventory $8,917.48; salvage at cost to wine stock $2,402.95; fire damage to salvaged wine stock $1,201.48; cost of salvaging wine $199.11. There is $20,500 insurance written in nine companies. Company A covers for $8,000; Company B, $1,500; Company C, $1,500; Company D, $1,250; Company E, $1,250; Company F, $1,250; Company G, $2,000; Company H, $1,250; Company I, $2,500. Company A is written with an 80 per cent coinsurance clause covering grocery stock and fixtures only. All other policies are written at flat rate covering grocery and wine stock and fixtures. Determine the loss and apportion the insurance.

PART III

TRANSPORTATION INSURANCE

Chapter XX

TRANSPORTATION INSURANCE

Two Major Divisions of Transportation Insurance. Transportation insurance, more usually known to the insurance business as "marine insurance," has to do with the insurance of property in transit or property incidental to the business of transportation. There are two major divisions in the field. The first of these, "ocean marine insurance," is very ancient in its point of origin and has to do primarily with the insurance of sea perils. The second division, surprisingly of comparatively recent origin, is "inland marine insurance." Inland marine insurance covers the risks of inland transportation.

Inland marine insurance is not limited, as might be expected, by the term to the risks of lake, river, or other inland waterway but covers the risks of all accepted methods of land transportation, such as railroad, truck, train airplane, and the like. Water-borne perils may form part of the risks covered by an inland marine policy when such perils form part of the transportation risk. In the process of development, inland marine insurance has extended to include a wide range of policy forms that embrace every conceivable method of transportation, outside of those risks that fall definitely within the ocean marine category.

Insurance Idea Develops in Connection with Transportation Hazards. The insurance of ocean marine risks, it has already been noticed, preceded the insurance of risks of all other types. The earliest of the ocean marine policies insured against the total loss of the vessel. An early step in the evolutionary process placed liability upon the insurance carrier for partial losses growing out of sea perils while an insured shipment was aboard ship, even though the ship itself eventually arrived in port. In the course of time, shippers began to discover that, even though they covered their goods while water-borne, damage such as total destruction by fire while they were on the docks at one end of the voyage or the other, could be quite as disastrous as a total loss of the vessel at sea. The first extension of ocean marine coverages, then, was to provide insurance on the cargo while on docks or quays. From this, it was but a step to make the

coverage effective at the warehouse of the shipper and terminate at the warehouse of destination. This form of cover was provided by the so-called "warehouse-to-warehouse clause." Ocean marine contracts were then available to protect merchandise while in transit and to include the hazards of both land and water conveyances between the warehouse at point of origin and the warehouse at point of destination. Thus was ocean marine insurance brought ashore.

Scope of Ocean Marine Insurance. The ocean marine business is highly specialized in its operation and is carried on primarily by large insurance companies. The outstanding exception to companies as insurers is, of course, Lloyd's of London. Ocean marine insurance concerns itself primarily with insuring against loss due to maritime perils. Every lawful maritime adventure may be the subject of a contract of ocean marine insurance; in particular, there is said to be a maritime adventure when:

a) Any ship goods or other movables are exposed to maritime perils. Such property is in this Act referred to as "insurable property";

b) The earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan or disbursements, is endangered by the exposure of insurable property to maritime perils;

c) Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.[1]

Unlike other forms of insurance written in this country, the ocean marine insurance market tends to be international in its scope. To this end, American insurance underwriters in quoting rates and soliciting business must be in a position to meet competition from abroad. This they have always been able to do, to the end that ocean marine insurance forms a large and important branch of the insurance business of the United States.

Contract Develops to Include Land Risks. Ocean marine contracts are now commonly written to protect merchandise while in transit and include the hazards of both land and water conveyances between the warehouse at point of origin and the warehouse at point of destination. Forms have been developed for special commodities. For example, flour and mill products shipped to northern Europe and the United Kingdom may be covered against "all hazards and

[1] Marine Insurance Act, 1906 (6 Edw. 7, c. 41), sec. 3.

dangers of transportation," from the time of leaving the mills in the interior of America by any conveyance by land or water, until safely delivered at any point of destination. Cotton is insured under ocean marine contracts during processing in compresses, while being shipped by land by either trucks or railroads, and on steamers until delivered abroad at point of destination. Other products, notably wool, are afforded a similar type of contract. It is the intention of the underwriters to assume particularly the perils of the sea but to extend the coverage so that the owner may know that his insurance is continuous from the time the products leave his hands until delivered into the hands of the consignee. This inclusion of land risks in the ocean marine contract focused attention upon the land transportation hazards, where ocean perils were not a factor. The development of insurance for land perils only resulted in the establishment of that branch of the business to which is applied the term "inland marine."

Liability of Carrier. It is generally understood that a common carrier is liable for goods entrusted to it for delivery. It is important, however, that the shipper understand the extent to which the carrier is liable. The common law liability has been thus expressed: "The law charges this person thus entrusted to carry goods, against all events, but Acts of God, and of the enemies of the King."[2] The case goes on to say, however great the force may be causing the loss, or however irresistible the multitude robbing the carrier, he is nevertheless responsible. This is so because it is necessary that persons entrusting their goods to carriers have confidence in them, and if they could escape their liability through connivance they could cause losses to shippers. The doctrine thus expressed in this old English case is part of our common law inheritance, and the citation represents an early formulation of the principle as carried forward in American law.

The early common law has been modified in but few respects. A carrier now is still not responsible for a loss occasioned by "an act of God." Nor is he held responsible for a loss caused by an order of the public authority or one occasioned by a public enemy. Acts or defaults of the shipper are exempted; nor is the carrier responsible for losses growing out of the inherent vice or nature of the goods. In no instance may a common carrier be freed from liability because of its own negligence.

[2] *Coggs* v. *Bernard*, 2 Lord Raymond 909; 1 Smith's Leading Cases 369.

Because of this stringent liability, shippers have been accustomed to look to the carrier for reimbursement for loss or damage. While the carrier remains responsible, developments in recent years have tended not to curtail the principle of liability but to limit the amount for which the carrier may be held.

Limitation upon Liability of Carriers by Sea. It has long been recognized that the perils of the sea and the dangers to navigation create risks for which the carrier could not equitably be held responsible, if they were the occasion of loss. In this country, the Harter Act exempts the owner of any vessel, while transporting property to or from a United States port, from responsibility for loss or damage growing out of faults or errors in navigation, losses arising from the perils of the sea or other navigable waters, and acts of God. The Maritime Law Committee of the International Law Association framed a set of rules now known as "The Hague Rules." It set forth the risks to be assumed by sea carriers under a bill of lading. These rules have been passed into law in their essentials and are widely followed by many countries. Under their terms, the carrier is bound before and at the beginning of a voyage to exercise due diligence to (*a*) make the ship seaworthy; (*b*) properly man, equip, and supply the ship, and (*c*) make the holds, refrigerating and cool chambers, and all other parts of the ship in which goods are carried fit and safe for their reception, carriage, and preservation. The carrier is bound to provide for the proper and careful handling, loading, stowage, carriage, custody, care, and unloading of the goods carried.[3] The rules then provide that the ship shall not be liable for loss or damage arising or resulting from unseaworthiness, unless caused by want of due diligence on the part of the carrier to make the ship seaworthy and to secure that the ship is properly manned, equipped, and supplied.

It is specifically stipulated that neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from: act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship; fire; perils, dangers, and accidents of the sea or other navigable waters; act of God; act of war; act of public enemies; arrest or restraint of princes, rulers, or people, or seizure under legal process; quarantine restrictions; act or omission of the shipper or owner of the goods, his agent or representative; strikes, lockouts, stoppage, or restraint of

[3] The Hague Rules, 1921, art. III.

labor from cause, whether partial or general; riots and civil commotions; saving or attempting to save life or property at sea; inherent defect, quality, or vice of the goods; insufficiency of packing; insufficiency or inadequacy of marks; latent defects not discoverable by due diligence; any other cause arising without the actual fault or privity of the carrier, or without the fault or neglect of the agents, servants, or employees of the carrier. Other immunities of a technical nature include freedom from liability or loss resulting from deviations to save or attempt to save life or property at sea. Provision is made for limiting liability on each package or unit unless a declared value is inserted in the bill of lading. There is also a section providing that the carrier may destroy or render innocuous without liability goods of inflammable or explosive material unless the nature and character have been described in writing by the shipper to the carrier before shipment and the carrier has consented to the shipment.[4] The Hague Rules have no direct bearing upon the contract of marine insurance. However, owing to the fact that when the rules are followed, the carrier may issue a bill of lading incorporating all or a substantial part of the rights and immunities set forth in the rules, they are of importance to the shipper as indicative of the risks he may be asked to assume, or if he wishes protection to cover himself through the purchase of a marine insurance contract.

Released Value Bills of Lading. From the earliest times, public carriers undertook to lessen the severe burden placed upon them by the common law liability. In England, notices were posted limiting the liability of the shipper and indicating that full liability would be assumed only on the payment of additional charges. In England, the method was held adequate to limit liability, but the situation continued generally unsatisfactory, and not until 1854 was the matter definitely settled with the passage by Parliament of the Railway and Canal Traffic Act which provided that the common law liability of carriers could be limited only by a written contract with the shipper. In order to effect this limitation, the carrier was required to accept a lower freight rate than would have been the case had it assumed the full common-law liability. Thus, it was early recognized that the carrier acted in a twofold capacity: first, that of providing transportation and, second, that of providing insurance against the hazards of transportation. If the insurance risk was lessened, that part of the

[4] *Ibid.*, art. IV.

rate which represented an insurance premium would naturally be reduced.

In this country, for a period, developments were the reverse of those in England. The carriers undertook to issue bills of lading limiting their common-law liability and as well limiting their liability for losses the outgrowth of negligence. Among other provisions, it was customary to deny liability for loss if it occurred beyond the limits of the line of the carrier issuing the bill of lading. This was the source of great confusion since it frequently was impossible for the shipper to determine exactly in whose hands the damage occurred. In 1906, the Interstate Commerce Act of 1887 was amended to hold the initial carrier liable for loss or damage caused by it or for loss, damage, or injury to such property caused by "any common carrier, railroad, or transportation company to which such property may be delivered or over whose line or lines such property may pass."[5] This amendment, known as the "Carmack amendment," provided that "no contract, receipt, rule or regulation shall exempt such common carrier, railroad, or transportation company, from the liability imposed by the Act." Prior to the Carmack Amendment some states were allowed to exempt themselves from all or a part of the common-law liability by rule, regulation, or contract. The situation was the reverse in other states, and federal courts customarily followed the local rule to the end that a carrier might be held liable in one court when under identical conditions he might be exempt from liability in another. The Carmack amendment definitely established the liability of the carrier for any loss, injury, or damage caused by it or a succeeding carrier to whom the property may be delivered. It did not, however, clear up definitely the matter of including provisions limiting liability in the bills of lading. Legislation was enacted in 1915, known as the first "Cummins amendment," which provided definitely for the full liability of the common carrier regardless of whether or not limitations were set forth in the bill of lading or in any other agreement. At this point the carrier was made fully liable for loss or injury caused on its own lines or the lines of succeeding carriers. Thus, the initial carrier became the insurer for the full amount of the shipment.

This situation was found to be generally unsatisfactory, and the

[5] For a discussion of the effects of the Carmack amendment see *Adams Express Co.* v. *Croninger*, 226 U.S. 491 (1913).

second Cummins amendment, which became effective in 1916, completely reversed the position taken by the first Cummins amendment by permitting limitations of liability or limitations to the amount of recovery, provided rates were predicated upon the values declared by the shipper. An exception was made in the case of livestock. Here we have definitely established by legislation the right of carriers to limit their liability for loss or damage to shipments through the terms of the bill of lading.

With the advent of "released liability bills of lading," certain commodities involving high values were frequently shipped with little or no protection. Shipments such as antiques, raw silk, oriental rugs, and other such items run to large sums, and the problem of their protection is a matter of serious concern to the railroad. Under a released liability bill, the insurance risk is reduced to a minimum. Indicative of the problem which carriers face and the necessity for being on guard against new hazards, in the spring of 1940, certain of the railroads engaged in the transportation of airplane engines filed a new freight tariff with the Interstate Commerce Commission which would more than double the then existing rate on engines. It was the contention of the carriers that the proposed increase was necessary because engines, being extremely valuable and subject to sabotage, placed a responsibility upon the railroads greater than was compensated for by the rate. Indicative of the fact that the increase represented an insurance premium, the carriers expressed a willingness to transport the engines without an increased rate under released liability bills of lading. Unquestionably, the released liability bill of lading appealed to the carrier apprehensive of insurance risks; and to the shipper, on the other hand, the lower rate appealed. The shipper, however, did not in all cases recognize the extent to which his shipment was subject to risk.

Railroad Shipments Involving Transportation by Water. When a shipment of goods originates with a railroad company and transportation by water is a necessary part of the trip, the question presents itself as to the liability of the initial carrier if losses occur while the shipment is water-borne. It was natural that carriers should wish to take advantage of the benefits of laws governing movements by water. Early interpretations of the Cummins Amendments made no change in the liability of the carrier, so far as the water-borne portion of the journey was concerned, if damage occurred to shipments mov-

ing under through rates and involving sea transportation as part of the journey. While the question was still in doubt, the Transportation Act of 1920 was passed. Its terms definitely provided:

> . . . . that if the loss, damage or injury occurs while the property is in the custody of a carrier by water the liability of such carrier shall be determined by and under the laws and regulations applicable to transportation by water, and the liability of the initial carrier shall be the same as that of such carrier by water."[6]

The act does not include lighterage in or across rivers, harbors, or lakes, when performed by or on behalf of rail carriers as "water carriage."

As a result of the situation as it now stands, it is important that the shipper know to what extent there is liability on the part of the carrier, if the shipment moves part way by water, for any loss that may occur during the water-borne portion of the trip. It sometimes follows as a result of competition that when part of the shipment is carried by water, the carrier provides insurance for the entire trip. Some rates are quoted as insured, and in such instances, the carrier provides marine insurance for the account of the shipper, and the charge therefor is incorporated in the through-rate. In other cases, the rates do not provide for marine insurance, although it frequently happens that the shipper may declare a value on all bills of lading and request insurance, in which case the insurance charge is included in the rate cover provided through an open policy carried by the steamship company. It follows, therefore, that a shipper may not know exactly the extent to which his shipment is protected unless he carefully studies the tariff to determine whether marine insurance is provided for the water-borne portion of the trip.

Liability of Carrier as a Warehouseman. When goods in the hands of a common carrier have reached their destination and have been placed in reasonable safety, the status of the carrier changes to that of a warehouseman. The laws in all jurisdictions are not the same as to precisely when the change becomes effective. Under the Uniform Storage Tariff, the carrier is obligated to send notices of arrival to the consignee and is liable as a carrier or insurer for a period of forty-eight hours after the first 7:00 A.M. after notice of arrival has been sent to the consignee. In some states no such notice is required.

[6] Transportation Act of 1920, sec. 20.

After the expiration of the period set forth limiting responsibility as a carrier, the carrier then becomes a warehouseman and is liable only for losses growing out of negligence. The difference in status becomes apparent when it is recognized that such losses as are occasioned by fire, burglary, or other hazards which involve no negligence would afford the shipper no protection if his goods were in the hands of a warehouseman; whereas, while in the custody of a carrier, the common law liability of the carrier would attach. It becomes apparent, then, that the status of the protection which the shipper may expect from the carrier can automatically change. Failure to provide adequate protection to meet such situations may entail a serious loss to the shipper.

Need for Transportation Insurance of Land Risks. Because of the exemptions from liability afforded carriers of sea-going transportation, the custom of insuring cargoes aboard vessels and, in fact, the vessels themselves, was established early. With the development of railroads into great systems representing vast investments, for many years shippers tended to look to them for reimbursement in the event of loss or damage to the goods shipped. The situation was by no means ideal. Shippers regarded themselves as primarily in the transportation business and not the business of insurance. The adjustment of losses was regarded as a necessary evil. While it may be presumed that it was the intention of the management of railroads to settle equitably all claims for which they were legally liable, questions of fact and of law frequently entailed much litigation and delay. The situation as it existed was not entirely satisfactory to shippers, and in some instances it was aggravated by failure on their part to understand thoroughly the effect of limitations of liability incorporated in the bills of lading. Because of these conditions, there developed a growing tendency on the part of shippers to seek transportation insurance from insurance companies. This demand was crystallized at the time of the first World War when the government took over the transportation systems of the country. The delays and disputes that had developed prior to the war were brought into sharp focus when it became apparent that, under government operation, the government was a factor in any claim for reimbursement. Shippers began to feel that they could expect an increase of any delays that had been experienced heretofore because of the increasingly complex setup of the transportation system. Rather than be faced with delay

and litigation as well as being disturbed by the element of uncertainty, private insurance was sought as a solution of the problem of transportation risks.

About the same time that the railroad situation was giving stimulus to the insurance of land transportation hazards, the automobile was becoming an increasingly important factor in the transportation system. Large trucking concerns developed. But the trucking business over highways was by no means limited to such companies, and trucking concerns of uncertain financial stability mushroomed almost overnight. While the shipper had a reasonable degree of assurance of the financial responsibility of railroads, in many instances he had little or no assurance of the ability of the trucking concern promptly to meet a heavy claim for loss or damage. With the introduction of trucking, a second feature made its appearance. Many times the shipper himself owned the trucks; therefore, unless the contents were insured by a separate carrier, the goods were in transit with no provisions whatever for reimbursement in the event of loss. To a lesser degree, the airplane exerted its influence. Shipments are now made regularly by airplane; but, in the beginning, shippers were apprehensive lest this method of transportation prove particularly hazardous. The sum of all these factors stimulated the demand for transportation insurance written by insurance companies, and out of this demand inland marine insurance became an established branch of the insurance business.

Insurance of Carrier's Liability. Up to this point, the discussion of the carrier's liability presupposes the ability of the carrier to settle losses for which it is liable. Because of the size and financial strength of railroads, the question of ability has not been an important factor. With the use of motor trucks as carriers, the owners of the trucks have viewed their liability as a very serious risk indeed. It is quite conceivable that the destruction of a shipment might entail a loss far in excess of the value of the truck upon which it was being transported. This led to a demand for insurance covering the legal liability of the carrier for damage to shipments entrusted to his care.

With the introduction of policies providing for the legal liability of carriers, it was but a step to provide the same protection for bailees. Not all persons operating transportation facilities come within the legal classification of common carriers. Some truckmen who do not operate regularly established routes, or who work primarily for one or

two customers, accept goods as a bailee; in this instance, they are liable for negligence and are not, as in the case of a common carrier, insurers of the goods. The bailee liability has been extended to a wide range of risks.

To meet the requirements of shippers, the comprehensive transportation policy was developed. The simplicity of its operation and the extent of the coverages afforded make the policy at once attractive to shippers of all classes of goods and merchandise, whether under a released liability bill or not. Rates are adjusted in accordance with the extent of the liability assumed and the general character of the risk. Likewise, policy forms have been developed to meet the requirements of the different classes of shippers.[7]

Inland Marine Underwriters Association. With the rapid development of transportation insurance and with the extension of the marine contract to the insurance of other hazards not readily insurable by fire and casualty companies because of the transportation risks, the inland marine business began to develop impressive premiums. The result was a period of intensive competition. The inland marine business had never been subjected to the same degree of regulation as that applying to fire companies, and the resulting competition brought about rate decisions and commission allowances that for a time threatened the successful continuance of this branch of the insurance business.

To introduce some stability to this branch and put an end to unregulated competition by adjusting rates and forms to meet needs and experience, a meeting of underwriting executives was called in December, 1929. A committee was appointed to formulate plans for an organization to control the writing of certain specified lines. After a period of study, plans for an organization were formulated, and the committee made the following recommendations at a meeting of companies held April 23, 1930:

First: To arrange by agreement to bring all lines susceptible to tariff rating by classes under the full jurisdiction of the Association.

Second: On lines not susceptible to tariff rating by classes but for the rating of which general formulae may be established, to arrange by agreement for the establishment of such formulae.

Third: On lines not susceptible to tariff rating by classes or to the estab-

[7] For a more comprehensive discussion of the subject, see Magee, J. H., *Property Insurance* (Chicago: Richard D. Irwin, Inc., 1941), chap. xvii.

lishment of rating formulae, to arrange as far as possible for uniformity of contracts.

It is further recommended that pending the conclusion of such special agreements all the companies make every effort in their power to avoid disturbing the situation as regards the uncontrolled lines.

The outcome of the meeting was the formation of an organization known as the Inland Marine Underwriters Association, and January 1, 1931, it commenced to function. Designed to effect stability and co-operation, its purposes are stated in its constitution in the following terms:

a) To develop and facilitate scientific and intelligent underwriting of all forms of Inland Marine and "All Risks" Insurance.
b) To study and promote simplification and accuracy of rating methods and rate presentation.
c) To investigate class or general hazards and to devise, advocate, and promote reasonable and proper means of reducing hazards insured against.
d) To secure the adoption by members of suitable and uniform policy forms and clauses.
e) To harmonize specific rates, rating formulae or other methods of rating.
f) To prevent rebating and unfair discrimination and to promote, regulate, advance, good underwriting practices.
g) To regulate agency commissions (including contingent commissions) and all other methods of remuneration to agents and brokers.
h) To serve as a medium for exchange of information.

Development of Jurisdictional Confusion. When inland marine policies finally became an accepted part of the business of insurance, the flexibility of the contracts and the breadth of the coverages so appealed to insureds that efforts were made by insureds to bring within the scope of the marine form, risks of almost every conceivable sort and risks, in some instances, in which the transportation element was nebulous if not nonexistent. The result was the beginning of what amounted to a boom in the writing of inland marine business.

As might be expected, with the phenomenal expansion that manifested itself in the early years of the development of inland marine business, competition entered the field to the end that conflicts and misunderstandings developed among fire, casualty, and marine companies. Unquestionably, many risks were accepted by marine departments that were called for by insureds because of the breadth of the marine cover and in which the transportation hazard was nonexistent. In some instances inland marine contracts were used as a vehicle for

providing insurance at less than the established rates. Marine departments were competing with fire insurance departments, often in their own companies. Marine companies likewise were competing with casualty companies. The situation reached a stage so acute that insurance departments were drawn into the controversies that developed, and an appeal was made to them to establish some control for the business.

As the result of many conferences between insurance officials and representatives of state insurance departments, the insurance companies themselves undertook to effect a solution of the problem. The Interstate Underwriters Board representing fire underwriters, the Casualty Committee representing the casualty underwriters, the Inland Marine Underwriters Association, and the Marine Casualty Committee appointed a joint committee with the purpose of attempting a satisfactory definition of marine insurance. A definition was finally worked out and was published by the Superintendent of Insurance of New York on June 2, 1933, and was approved with but slight modifications at the Convention of the Insurance Commissioners of the United States and by resolution unanimously adopted as the definition of marine underwriting powers. The agreement was voluntarily subscribed to by the majority of marine underwriters, and thereby the insurance business itself solved a problem that at one time appeared to be getting out of hand. It is now known as the "Nation Wide Definition and Interpretation of the Insuring Powers of Marine and Transportation Companies." It is used as the basis of the ruling of the line of demarcation of the underwriting powers of marine insurers by the insurance commissioners or superintendents of insurance. In all states certain exceptions to the "Definition" have been permitted, but the basic framework has been accepted.

The Nation Wide Definition is divided into two parts. The first part provides the conditions under which marine and transportation policies may cover (*a*) imports, (*b*) exports, (*c*) domestic shipments, (*d*) bridges, tunnels, and other instrumentalities of transportation and communication, and (*e*) personal property floater risks. The second part provides that marine and/or transportation policies shall not cover under the following conditions: (*a*) storage of insured's merchandise, except as hereinbefore provided; (*b*) merchandise in course of manufacture, the property of and on the premises of the manufacturer; (*c*) furniture and fixtures in use, or improvements to buildings

except as provided above; (*d*) fire risk on all building materials while in course of erection after seller's interest ceases; (*e*) fire or other risks on merchandise in permanent location, sold under partial payment, contract of sale, or installment sales contract, which involves protection of the purchaser's interest after seller's interest ceases; (*f*) risks on moneys and/or securities in safes, vaults, safety deposit vaults, bank or insured's premises, except while in course of transportation; (*g*) any policy substantially the equivalent of "the personal property floater," sometimes referred to as "the householder's comprehensive" (all states permit the issuance of personal property floater policies); (*h*) risks of fire, tornado, sprinkler leakage, earthquake, hail, explosion, riot and/or civil commotion on buildings, structures, wharves, piers, docks, bulkheads, sheds, and other fixed real property on land and/or over water, except as provided in section (*d*) of the first part of the Definition.

Committee of Interpretation and Complaint. Following the action of the National Convention of Insurance Commissioners defining marine insurance, articles of agreement were drawn up between individual companies writing fire, marine, and casualty business. Those companies which become parties to the agreement bind themselves to accept the Definition of the National Convention of Insurance Commissioners and to be governed thereby in their underwriting.

Provision is made in the articles of agreement for a committee whose duty it is, among other things, to hear complaints and to enforce the agreement among the subscribing members. The committee is made up of twelve members, of whom five are appointed by the American Institute of Marine Underwriters, five by the Interstate Underwriters, and two by the National Bureau of Casualty and Surety Underwriters. This committee is authorized to interpret the Definition and issue rulings with respect to disputed situations. Appeal may be made to a standing committee of the National Convention of Insurance Commissioners composed of three commissioners with authority to review questions of interpretation and definition.

Flexibility of Inland Marine Contract Has Wide Appeal. The limits to which the broad all-risks inland marine contracts could reach in providing insurance protection was soon discovered both by insurance underwriters and by insureds. Inland marine contracts have proved to be among the most flexible in the business, to the end that

PROSPECTS FOR INLAND MARINE INSURANCE

Showing Types of Insurable Property and Name of Available Policy to Cover*

Type of Property	Name of Policy
Airport Operators	
Airport premises	Airport Liability
Armories	
Flags, Colors and Equipment	Scheduled Property Floater
Musical Instruments	Musical Instrument Floater
Paintings; objects of historical value	Fine Arts
Privately owned Saddle Horses	Horse and Wagon Floater
Art Collectors, Dealers and Galleries	
Paintings, Statues, Works of Art, Antiques and objects of rarity or historical value	Fine Arts
Aviation Flight Instructors	
Aircraft	Aircraft Hull & Liability
Instructors	Aviation Accident & Comp.
Students	Aviation Accident
CPTP Courses	Aircraft Liability Aviation Accident
Bands	
Musical Instruments	Musical Instrument Floater
Uniforms and Paraphernalia	Scheduled Property Floater
Banks	
Customers' Fur Storage	Furriers' Customers
Financed Aircraft	Aircraft Hull
General Merchandise	Installment Sales
Securities and Currency	Armored Car Messenger Registered Mail
Breweries	
Beer, Containers and Cases	Transportation
Horses and Wagons	Horse and Wagon Floater
Cemeteries	
Power lawn mowers, chapel tents, lowering devices, sod covers, cocoa matting, artificial grass and other tools and equipment	Scheduled Property Floater
Churches	
Paintings, Works of Art, and Stained Glass Windows	Fine Arts
Projection Machines	Camera Floater
Religious Articles, Vestments	Scheduled Property Floater
Cleaners, Dyers and Laundries	
Customers' Furs for storage	Furriers' Customers
Customers' Goods	Bailee's Customers
Horses and Wagons	Horse and Wagon Floater
Clubs	
Aircraft	Aircraft Hull & Liability Aviation Accident
Amateur Theatrical Scenery and Props	Theatrical Floater
Guns	Gun Floater
Horses and Saddlery	Horse and Wagon Floater
Paintings, Works or Art, and Stained Glass Windows	Fine Arts
Power Lawn Mowers	Scheduled Property Floater
Projection Machines	Camera Floater
Property on Exhibition	Scheduled Property Floater
Contractors	
Horses and Wagons	Horse and Wagon Floater
Machinery, Tanks, etc.	Installation Floater
Road Equipment	Contractors Equipment Floater
Department Stores	
Merchandise	Department Store Floater Exhibition Floater Installation Floater Installment Sales Motor Truck Cargo Parcel Post Transportation
Doctors, Clinics, Hospitals and Veterinarians	
Cameras & Projectors	Camera Floater
Medical Lamps	Medical Lamp Floater
Radium	Radium Floater
Surgical and Scientific Instruments and Apparatus	Physicians and Surgeons Instrument Floater
Engineers and Surveyors	
Transits, Levels, etc.	Scheduled Property Floater
Exhibitors	
Property on Exhibition	Scheduled Property Floater
Works of Art	Fine Arts
Express Companies, Freight Forwarders and/or Packers	
General Merchandise	Motor Truck Cargo Floater Ocean Cargo Transportation
Furriers	
Customers' Goods	Furriers' Customers
Government (Town, City, County or State)	
Airports	Airport Liability
Bridges	Bridge Property Damage Bridge Use and Occupancy
Exhibitions	Scheduled Property Floater
Musical Instruments	Musical Instrument Floater
Power Lawn Mowers	Scheduled Property Floater
Road Machinery and Equipment	Contractors Equipment Floater
Securities, etc.	Registered Mail
Surveyors' Instruments	Scheduled Property Floater
Voting Machines	Scheduled Property Floater

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Continued on Page 426.

PROSPECTS FOR INLAND MARINE INSURANCE (*Continued*)

Showing Types of Insurable Property and Name of Available Policy to Cover*

Type of Property	Name of Policy
Individuals	
Aircraft	Aircraft Hull & Liability Aviation Accident
Cameras	Camera Floater
Collections	Scheduled Property Floater
Furs	Fur Floater
Golf Equipment	Golfers' Equipment Floater
Guns	Gun Floater
Jewelry	Jewelry-Fur Floater
Musical Instruments	Musical Instrument Floater
Outboard Motors and Boats	Outboard Motor Boat
Paintings, Tapestries, Rare Books, Valuable Rugs and other objects of art	Fine Arts
Personal Effects	Personal Effects Floater
Personal Property	Personal Property Floater Trip Transit
Power Lawn Mowers	Scheduled Property Floater
Riding Horses, Saddlery and Equipment	Horse and Wagon Floater
Ship Models	Scheduled Property Floater
Scientific Instruments	Scheduled Property Floater
Silverware	Silverware Floater
Stamp Collections	Stamp Collection Floater
Wedding Presents	Wedding Present Floater
Yachts and Motor Boats	Yacht and Motor Boat
Libraries and Museums	
Exhibitions	Scheduled Property Floater
Paintings, Works of Art, Rare Books and Manuscripts, Stained Glass Windows	Fine Arts
Lodges, Fraternal Organizations and American Legion Posts	
Musical Instruments	Musical Instrument Floater
Paraphernalia, Flags, Uniforms	Scheduled Property Floater
Projection Machines	Camera Floater
Works of Art, Statuary, Bronzes	Fine Arts
Merchants, Manufacturers, Distributors, Wholesalers and Retailers	
Aircraft	Aircraft Hull & Liability
General Merchandise	Exhibition Floater Horse and Wagon Floater Installation Floater Installment Sales Floater Motor Truck Cargo Ocean Cargo—Export, Import and Intercoastal Parcel Post Processing Floater Salesman's Floater Transportation—All Modes
	Scheduled Property Floater
Ladies' and Men's Wear	Garment Contractors Floater
Neon Signs	Neon Sign
Patterns, Dies, Molds	Pattern Floater
Musicians, Orchestras and Bands	
Musical Instruments	Musical Instrument Floater
Uniforms	Scheduled Property Floater
Photographers	
Aircraft	Aircraft Hull & Liability
Cameras and Equipment	Camera
Photographic Supplies	Parcel Post Transportation
Radio Stations	
Radio Towers	Scheduled Property Floater
Schools and Colleges	
Athletic Equipment	Scheduled Property Floater
Bandsmen's Uniforms	Scheduled Property Floater
Cameras, Projectors and Sound Equipment	Camera
CPTP Courses	Aviation Accident
Exhibitions	Scheduled Property Floater
Flags and Colors	Scheduled Property Floater
Guns	Gun Floater
Horses and Saddlery	Horse and Wagon Floater
Musical Instruments	Musical Instrument Floater
Paintings, Works of Art, Rare Books and Manuscripts	Fine Arts
Theatrical Scenery, Costumes and Props	Theatrical Floater
Trophies	Scheduled Property Floater
Service Men	
Caterer's Equipment	Scheduled Property Floater
Floor Surfaces	Contractors Equipment Floater
Sandblasting Equipment	Contractors Equipment Floater
Service Equipment	Scheduled Property Floater
Welding Equipment	Contractors Equipment Floater
Truckmen	
General Merchandise	Motor Truck Cargo
Horses and Wagons	Horse and Wagon Floater
Warehousemen	
Customers' Furs	Furriers' Customers
Horses and Wagons	Horse and Wagon Floater
Household Goods and General Merchandise	Motor Truck Cargo Transportation
Wool Growers	
Wool, Mohair and Sheep Pelts	Wool Growers'

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adequate coverages have been made avaliable in a form that would have been most difficult had it been necessary to insure separate perils with fire, casualty, and marine underwriters. For example, an art collector or dealer may secure a comprehensive policy covering paintings, statues, or other works of fine art. Bands may insure their musical instruments wherever they may be. Churches may insure paintings, works of art, religious articles, and vestments. Owners of certain types of business establishments may protect their customers' goods left with them for processing. Doctors may insure surgical and scientific instruments. Governments may insure airports, bridges, voting machines, road machinery and equipment, and the like. Libraries and museums may cover rare books, paintings, and manuscripts. There is almost no limitation to the uses of inland marine insurance other than that the risk fall within the limits of the uniform Definition and that the insured have an insurable interest in the subject matter of the insurance. The extent to which the inland marine policy has been adopted by business and professional men as well as individuals in connection with the handling of their personal affairs is shown by the prospect list for inland marine insurance on pages 425 and 426.

War Risks. Following the outbreak of World War II both ocean and inland marine underwriters took steps immediately to eliminate the perils of war risk from all policies. It was felt that the underwriting of war risks constituted a problem entirely separate from that of underwriting ordinary transportation hazards such as those that fall within the category of the "perils of the sea" or "perils of land transportation."

When war risk coverage is desired and obtainable, it is written under the ocean marine contract in the usual course as a separate policy. In the inland marine contract, it may be written as a separate policy, although war perils may be attached to the marine contract covering other transportation perils. As a matter of fact, virtually no land transportation war risk coverage is written by private underwriters in any country that is actually a belligerent. War risk coverages will be noted further in the discussion of the different types of transportation cover.

FOR REVIEW

1. X operates a small foundry, and with many of his orders his customers supply patterns. He raises the question whether under the inland marine

form he can insure his legal liability for these patterns while they are in his custody, provided property of the insured on the premises of the insured is excluded. What is your opinion?

2. In your opinion, is the rolling stock of a railroad properly the subject matter of an inland marine insurance policy?
3. Miss B runs a small circulating library and rents space in a neighborhood drug store. It is her contention that a comparatively small number of her books remains on the shelves of the drug store at any one time. She wishes the entire library insured under an inland marine policy. In your opinion, is this possible?
4. In your opinion, could the manufacturer of a soft drink with a wide geographic distribution insure his beverage containers under an inland marine policy?
5. X is a finance company and is engaged in financing merchandise such as radios, washing machines, heating plants, and the like on a partial payment basis. These items, when once installed, in the ordinary course involve no further element of transportation. X states that it is impossible for him to insure his interest in each specific location and requires an inland marine policy covering his interest at whatever location he has an interest. Is this possible?
6. B contends that most of his shipments are made by railroad and that he is quite satisfied with the responsibility of the railroad in the event of loss or damage. X asks if he has ever given thought to the difference in the responsibility of the railroad as a common carrier and as a warehouseman. Indicate the difference in the liability of the railroad in the two situations.
7. A copy of a policy has been submitted to the joint committee containing the following three clauses:

> This policy covers upon leaf, loose, scrap and stem tobacco, tierces, hogshead and other packages used in the transportation of tobacco, the property of the Assured or others for which the Assured may be liable as bailee and/or warehouseman and held by the Assured in trust or on commission, or on joint account with others or sold but not delivered.
>
> This policy covers the property insured against the risks of transportation as hereinafter specified from the time the property leaves the plantation, farm, barn and/or warehouse of the shipper or place of pickup while loaded for shipment and/or in transit in or on carts, wagons, automobiles, and/or motor trucks owned and/or operated by the Assured or by others, until safely delivered to the warehouse of the Assured herein specified, but only in due course of transit.
>
> This policy also covers while such property is in the custody of the Assured in and/or about their Tobacco Sales Warehouse for purpose of auction and/or sale, situate.....but in no event for a period of time of longer than thirty (30) days after arrival at the above stated premises.

The committee disapproved the form. Can you explain why?

Chapter XXI

OCEAN MARINE INSURANCE

Definition. In the beginning, marine insurance was, as the name implies, insurance against risks connected with navigation. The ship, cargo, freight, profits, and other insurable interests are exposed to a wide variety of hazards during a voyage. To protect the owner of the interest against loss, marine forms were designed.

Perils Covered by the Ocean Marine Contract. It has already been noted that a contract of marine insurance may, by its express terms, be extended so as to protect the insured against any land risk which may be incidental to the sea voyage. Land risks are likewise covered in some instances as a matter of usage of trade. Ocean marine insurance contracts are also written to cover ships in course of construction and include as well perils incidental to launching. Marine adventure and marine perils have been thus defined:

> Touching the Adventures and Perils which we, the said Underwriters, are contended to bear and take upon us, they are of the Seas, Men-of-War, Fire, Enemies, Pirates, Rovers, Thieves, Jettisons, Letters of Mart and Counter-Mart, Surprisals, Takings at Sea, Arrests, Restraints and Detainments of all Kings, Princes and Peoples, of what nation, condition or quality soever, Barratry of the Master and Mariners and of all other like Perils, Losses and Misfortunes that have or shall come to the Hurt, Detriment or Damage of the said Vessel, &c., or any part thereof; excepting, however, such of the foregoing Perils as may be excluded by provisions elsewhere in the Policy or by endorsement. And in case of any Loss or Misfortune, it shall be lawful for the Assured, their Factors, Servants and Assigns, to sue, labor and travel for, in, and about the Defense, Safeguard and Recovery of the said Vessel, &c., or any part thereof, without prejudice to this Insurance, to the Charges whereof the Underwriters will contribute their proportion as provided below. And it is expressly declared and agreed that no acts of the Underwriters or Assured in recovering, saving or preserving the property insured shall be considered as a waiver or acceptance of abandonment.

Perils of the sea include sinking, capsizing, stranding, collision of the vessel, and unusually heavy weather. Contact of insured goods with sea water due to any of the foregoing causes and resulting in damage is a loss under the policy, and losses caused by vapor and gases rising from a part of the cargo damaged by sea water have been paid.

Fire is specifically listed in the policy when the hazard is to be covered, since fire is regarded as a peril *on* the sea and not *of* the sea. With respect to what constitutes a fire and what damages are collectible, the rules follow those already considered with respect to land policies. Fires in port as well as those at sea are covered, and even those ashore if the transfer forms part of one unbroken voyage.

Pirates and rovers, while formerly important hazards, are of little or no importance today as perils. Thieves, when stated as perils against which the insurance is written, are interpreted in this country to mean those who bring about losses where there is no element of violence, and may be not only strangers but also the passengers and the crew. When the term "assailing thieves" is used, clandestine theft and pilferage are not covered; nor is theft which has been committed by the ship's company, whether passengers or crew. Under this term, the peril covered is theft by force originating from the outside.

Barratry embraces within its scope any willful misconduct against the owner by the master, officers, or crew. Any complicity on the part of the owner with the perpetrators of the act removes it from the category of barratry.

Jettison is the deliberate sacrifice of property. It includes throwing overboard part of the cargo, or any other property aboard ship, as well as cutting away the masts or rigging to relieve the ship in an emergency.

Letters of mart or counter-mart, surprisals, takings at sea, arrests, restraints, and detainers of all kings, princes, and peoples are perils of little concern today and are frequently not found in the policy.[1]

The final phrase embracing within the scope of the coverage *"like* perils, losses and misfortunes" is not as comprehensive as at first it might appear. Through the operation of the principle of construction that general words are restrained by the particular recital, it has

[1] Letters of mart were commissions granted by a sovereign power to persons whose property had been seized by subjects of other states. They authorized the holders to make reprisals in order to indemnify themselves for their loss. Letters of counter-mart authorized the holder to resist threatened reprisals. Capture and restraint, when insured against, are covered whether the act is committed by a public enemy, a belligerent, or the insured's own government. The word "people" has been defined to mean "the power of the country," and hence would not include an armed mob. "Capture" or "seizure" means the taking with intent to keep. Arrest or detention is the taking with the intent to return. "Takings at sea" is a broad term and includes the loss of control or possession of property by force, regardless of whether the act be legal or illegal, such as by mutiny, pirates, or mistaken seizure. Reference to men-of-war and enemies means those authorized by governmental authority to make war.

become settled that the reference to other perils means perils of the same nature as those already described, though they need not be strictly identical with those enumerated. It is pointed out that if the policy were intended to cover all risks, the specific enumeration of any list of perils would be unnecessary. When policies have been issued with the phrase "against all risks" written into the contract, it has been held that the policy in this case extends to risks other than those usually contemplated and covers all losses except those arising from fraud of the insured.

No Standard Marine Policy. The modern ocean marine policies take their point of departure from the Lloyd's contract. The contract in use today is, in turn, the form adopted in 1779. This form appears in the first schedule of the Marine Insurance Act of 1906, in which Great Britain codified its marine insurance law. It is notable that even here the Lloyd's form is not made mandatory.

In the United States, the Lloyd's policy serves as the general frame around which the various contracts offered by the insurance companies have been built. The value of the ancient phraseology and the reason for its retention lies in the fact that in the long period of its use, meanings have been definitely settled through the process of litigation. The policies have been enlarged and extended, and many of the clauses that first found their way into the Lloyd's contract as endorsements are now included in the printed forms as permanent parts of the contract. Because of the international nature of marine insurance and because of the exigencies of competition, coverages have assumed a considerable degree of uniformity. In the United States the American Institute of Marine Underwriters has developed a number of standard cargo clauses reflecting the generally accepted practice in the American marine market. These clauses have met with considerable approval on the part of both underwriters, brokers and insureds. The hope has been expressed that this development may lead to the adoption of a uniform ocean marine policy. The fact remains, however, that in the field of marine insurance there are no standard forms made mandatory by law.

The contract is positive in its nature, stating definitely the perils which the insurance covers. In contrast to the situation in fire insurance, in marine insurance the policy is usually written on a valued form, and unless full insurance to value is carried the insured must contribute to any loss an amount proportionate to the deficiency. In

the settlement of a loss under a marine policy, the liability of the insurer is similar to that of an insurer under a fire policy with the 100 per cent coinsurance clause. The principle is so thoroughly understood that it is recognized as established in law and need not be inserted in the policy in the form of a coinsurance clause.

Finally, in marine insurance it is essential that the insured familiarize himself with the doctrine of implied warranties. Warranties of this class need not be and seldom are incorporated into the policy, for by law, without any expression on the part of the parties, they are made a part of the agreement. As with all other warranties, strict compliance is necessary, and they form a condition precedent before any obligation exists on the part of the insurer. If the condition be broken at the inception of the risk, there is no contract whatever and the policy is void.

Seaworthiness. Perhaps the most important of the implied warranties is that of seaworthiness. The standard of seaworthiness is not the same for every port, and as a rule the acceptable standard is that of the port where the vessel belongs. Again, requirements vary with the type of vessel, her destination, or use. Generally speaking, the ship must be tight; properly equipped to withstand common dangers to be anticipated; with cargo properly stowed and not in excess of safe carrying capacity; with necessary food, fuel, water, and other stores; with a competent master, officers, and crew; and with a pilot when one is required by law or usage.

It is important to recognize the point that when there is an implied warranty as to seaworthiness, it does not follow that the unseaworthy condition of the vessel must be a matter of knowledge to the insured. The insured may have no knowledge whatever of the condition and find his insurance to be invalid because of a breach of warranty. The rule applies with the same force when a cargo is shipped in a vessel over which the insured has no control and when he is without knowledge of the condition that renders her unseaworthy.

Deviation. A second implied warranty, well established as a rule of law, provides that the vessel insured must not deviate from the proper course of the voyage. This warranty is based upon the reasoning that the insurer is entitled to have sufficient knowledge of the voyage contemplated to judge the perils involved. To vary the voyage amounts to a variation of the risk. Extending the idea of risk

variation, it is held to be a deviation if the risk insured against be materially changed without just cause.

A deviation is a voluntary act. Any act, therefore, that has the effect of changing the risk is not technically a deviation if it is the result of compulsion. When necessity is the compelling motive, the change in risk is not regarded as voluntary. Therefore, when through necessity there is a change in the voyage for repairs, water, or provisions, the change is not regarded as a deviation. Likewise, changes or delays occasioned by efforts to save life or give aid in cases of distress do not operate as a deviation, though a change made in the interest of property jeopardized is not subject to the same rule. Changes in the voyage to avoid a peril may not be a deviation, nor does the threatening peril need be one against which the insurance was written.

The proper course which a ship is expected to follow is the most usual one and the one that custom would justify the insurer to assume that the insured would follow. Where there is no usual course, the safest and most advantageous way is the one to follow. Touching a port not in the voyage, unless justified by usage, is a deviation, as is an unreasonable and unnecessary delay in commencing a voyage. Deviation has the effect of terminating the insurance.[2]

Illegality. Another warranty implied in maritime insurance is concerned with the question of legality. To comply with the warranty against illegality, the adventure must be lawful and, so far as it is within the control of the insured, carried out in a lawful manner. The question of what constitutes illegality in the case of an American ship and American insurance is determined by American law. Cases of illegal adventures include trading with an enemy, violating neutrality laws, smuggling, breach of a blockade, and other similar adventures prohibited by law. Insurance which has been effected to cover such undertakings is void.

Insurable Interest. As in the case of fire insurance, the insured

[2] In the case of *Burgess* v. *Equitable Mar. Ins. Co.*, 178 Mass. 70, the court supplies an example of the operation of the doctrine. The "Christie Johnstone" was insured "at and from Plymouth to the Banks, codfishing, and at and thence back to Plymouth." Ordinarily depending upon squid caught on the Banks to supply additional bait, on this particular voyage, because of a scarcity of bait, the vessel put into the port at St. Peters for a supply. The trip from the Banks to St. Peters and return consumed about a week. Some time after the return to the Banks the vessel sprang a leak in a gale and was lost. It was held that the departure had nothing to do with the loss, but since it was in fact a deviation it voided the policy. If the insurance is terminated by a deviation, the insurers continue to be liable for any loss caused by a peril insured against that may have occurred before the deviation.

must have an interest in the subject of insurance in order to effect an enforceable contract. This interest must be at risk, and the indemnity for which the insurer is liable is measured by the loss sustained. When valued policies are used, they have the effect of making the agreed valuation binding upon both parties to the insurance. As in the case of fire insurance, any interest may be insured if the peril would have the effect of causing the insured pecuniary loss. It is not necessary that the insured have an interest equal to the whole value of the subject matter, nor is it necessary that the interest exist when the insurance is effected. It is sufficient that the interest attach during the term of the policy, but it is absolutely essential that it exist at the time of the loss.

Types of Loss. There are two types of losses for which the marine contract assumes liability. The first are those which are incidental to a voyage at sea, but which need not involve destruction of the property insured. Losses of this type arise from the liability of the owner of the goods to make payment in accordance with the rules of maritime law. The second type of loss involves loss or damage to the subject of insurance of which the proximate cause was one or more of the perils against which the insurance was written. As in the case of fire insurance, the loss may be partial or total. A total loss may be actual, or it may be constructive.

Average. In connection with maritime insurance losses, the term "average" appears frequently. The etymology of the term is not altogether certain, though the contention that it is derived from the French word *avarie* and means "loss" or "damage" is in line with its present-day use. A "general average loss" is one made to fall on all the interests at risk in a given voyage. The term "particular average" is used when the loss is to some part of a risk and is of a nature to carry with it no right of contribution from other interests. The term as used today, though held by some writers to be obviously inaccurate, has by common acceptance come to mean "partial loss."

When the insured, under the terms of the policy, assumes a given percentage of every loss, the amount he thus assumes is termed the "deductible average." On the other hand, if the subject of the insurance is covered in such a way that the insurer becomes liable for loss only in the event that the loss exceeds a designated percentage of value, the percentage limitation is termed "average limitation."

When the insurer thus becomes liable, he must pay in full without deduction.

General Average. When the cargo, or a part thereof, is thrown overboard or a part of the vessel is sacrificed for the purpose of lightening or relieving the vessel in case of necessity or emergency, the property sacrificed is said to have been "jettisoned." By the provisions of the ancient Rhodian law, property jettisoned to save other property must be contributed for by the property saved. This is the law today. The contribution is termed the "general average."

Essentials for General Average Claim. There are three essentials, each of which must be present, in order to establish a claim for general average. The sacrifice must be (1) voluntary, (2) necessary, and (3) successful.[3]

From the foregoing it follows, therefore, that if a mast is carried away in a storm, even though the ship rides more easily thereafter, there can be no claim for general average. The act was not voluntary. The reverse is true, however, if the captain orders the mast cut away. Again, if the property for which the sacrifice is made is not saved, obviously the owners derived no benefit from the sacrifice and are accordingly under no obligation to contribute to a general average claim.

Salvage. The term "salvage" in connection with insurance and maritime law has two distinct meanings. In general, as an insurance term, salvage refers to property which is saved. Thus, we say that after a loss so much property was salvaged. In contrast to this use of the term, in admiralty it means the compensation due to those who voluntarily assist in saving a ship or cargo in peril. Salvors have a legal interest in the property saved, and if they and the owners of the property are unable to agree upon an amount for a reward, the amount is fixed by an admiralty court.

There is no fixed rule as to the amount of salvage. A vessel deserted by her crew without the intention of return is said to be a

[3] The rule was laid down in the frequently cited case of *Bernard* v. *Adams,* 10 How. 270, 303, when it was stated: "In order to constitute a case for general average, three things must occur: 1st. A common danger; a danger in which ship, cargo, and crew all participate; a danger imminent and apparently 'inevitable,' except by voluntarily incurring the loss of a portion of the whole to serve the remainder. 2d. There must be a voluntary jettison, *jactus,* or casting away, of some portion of the joint concern for the purpose of avoiding this imminent peril, *periculi imminentis evitandi causa,* or, in other words, a transfer of the peril from the whole to a particular portion of the whole. 3d. This attempt to avoid the imminent common peril must be successful."

"derelict." In the case of a derelict, an old rule awarded the salvors one-half of the property saved. This rule is now considered obsolete, though one-half of the value is held to be an upper limit for salvage in the case of a derelict, with one-third of the value as a lower limit. In cases other than derelict, the amount depends upon danger, risk, time expended, and skill necessary to save the threatened property. The work of salvors reflects to the benefit of the marine underwriters, and the marine policy assumes the liability for salvage obligations.

York-Antwerp Rules. Because of the great difference in the detailed rules for the adjustment of general average losses in the different parts of the world, reference is frequently made in the policy to the code to be followed. The regulations commonly used are known as the "York-Antwerp Rules." This code was adopted by the Association for the Reform and Codification of the Law of Nations at meetings held at York, England, in 1864, and at Antwerp, Belgium, in 1877, and was revised and amended in 1890 at the Liverpool, England, conference, and in 1924 was again further amended at Stockholm, Sweden. The rules cover specifically such questions as the amount to deduct from the cost of repair of ships of different ages and construction, as well as questions involving the cutting away of wreckage, voluntary stranding, jettison of deck cargo, loss of sale, damage to engines in refloating the ship, expenses of lightening the ship when ashore, damage to the cargo in discharging, temporary repairs, loss of freight, and other disputable points.

In addition to a reference to the rules in the policy, it is customary to provide in bills of lading for their use. Where, however, the rules do not apply, the law applying at the port of destination or other port agreed upon is used in effecting the adjustment.

The Sue and Labor Clause. The latter part of the section reciting the perils assumed by the insurer states that "it shall be lawful and necessary to and for the assured" and his representatives to take certain designated steps to prevent, limit, or reduce loss. This section is termed the "sue and labor clause," and under it the insured not only is permitted without prejudice to his rights but is obligated to take such steps as are reasonable to minimize or avert loss. The expenses thus incurred are collectible under the provisions of the clause without reducing the amount of insurance available to provide indemnity caused by the perils insured against. Three factors are essential to establish a claim under the sue and labor clause: (1) The expenditure

made must have been for the benefit of the particular property covered by the policy; (2) the expenditure must have been made to avert a loss for which the underwriters would be liable; and (3) the steps taken in the interest of the property for which compensation is claimed must be the act of the insured or his agent. Under the foregoing, it is apparent that general average charges may not be assigned to the sue and labor clause. If fire were not included among the perils insured against, expense incurred to save the property from a fire damage would not be recoverable. Finally, the insured or his agent must initiate the act for which the expense is incurred. For example, when voluntary salvors act to save the insured property, because they act of their own accord and are not agents of the owner, their reward may not be charged to the sue and labor clause. When the salvors act under contract with the insured, however, the charge is a proper one.

This clause operates, in effect, as a collateral agreement separate and apart from the provision to indemnify for loss or damage from the named perils. It was inserted in the policy to promote diligence on the part of the insured or his representatives in preserving and protecting insured property with the view to preventing or reducing loss. The compensation provided is not regarded as the payment of a partial loss and is, therefore, not subject to percentage restrictions that may apply to particular average claims. In the case of a total loss this compensation must sometimes be paid over and above the full face of the policy.

Total Loss. In the fire insurance policy, it is provided that there can be no abandonment of the damaged property to the insurers. In marine insurance the situation is not the same, and accordingly there are total losses that are actual and those that are constructive. When the subject of the insurance is wholly destroyed, irreparably damaged, or taken from the insured without hope of recovery, the loss is total and actual. When the loss becomes total only because the subject matter of the insurance is abandoned, or the entire property is not actually destroyed, the loss is termed "constructive." There is a constructive total loss when the subject of the insurance has some measurable value and is available to the interested parties where it lies. So far as the insured is concerned, the loss is total, although there may be some salvage to the underwriters.

An actual total loss does not require that the property be annihi-

lated. It is sufficient that it be so destroyed that it no longer remains the thing it formerly was, or that it be beyond human means of recovery, as when it is sunk, or that it be irretrievably gone, as when it is captured.

When an owner is dispossessed of his property but entertains a hope of recovery, or when there is a valuable remnant of the property, it is at once apparent that the loss cannot in fact be claimed as total. Early efforts to settle such claims as partial losses, however, were found not to be altogether satisfactory and were replaced by transferring to the insurers such value as remained, claiming a total loss under the insurance. This is the type of loss to which the term "constructive total" is applied.

Not in every case of partial loss is the insured entitled to abandon and claim a total loss, nor are the rules in England and the United States identical. In England, when the cost of recovering the ship or goods would exceed their value when recovered, or when a ship is so damaged by a peril insured against that the cost of repairing would exceed the value of the ship when repaired, abandonment is permitted. In this country, abandonment is held to be justified, with the consequent claim for a total loss, if the cost of repairs or expenditures will be in excess of 50 per cent of the value of the property when restored. American policies, by so providing in the contract, may make mandatory the English rule.

Particular Average. As in other forms of insurance, most marine losses are partial. A particular average loss differs from a general average loss in that it remains where it falls without contribution from other interest, and differs from a total loss in that the property insured is not destroyed or lost in its entirety. A part of a shipment may be totally lost, in which case the loss is total of the part and not one of particular average. The rules for ascertaining the amount of a particular average loss differ to a considerable degree with the interest involved. The more common interests which are the subject of insurance are the hull, the cargo, and the freight. Particular average losses on these interests are to be noticed separately.

Partial Loss of Hull. When a vessel is so damaged that there is an evident loss, but not of a degree to warrant abandonment to the insurers, the measure of indemnity is predicated upon the cost of repairs less any improvements resulting therefrom. Subject to the limit set by the face of the policy, the insured is entitled to the reasonable

cost of repairs, less the customary deduction when the repairs are supplied "new for old." The question of deductions to be taken because of new for old is not altogether the simple problem today that it was formerly. In the days of wooden vessels, an arbitrary rule allowed a deduction of one-third of the cost of repairs. With the advent of metal vessels, the arbitrary rule of one-third was held to be excessive, particularly in the case of new vessels, and as a consequence, a modified percentage depending upon the age and condition of the vessel and the character of the repairs became usual.

If the vessel is not repaired and the cost, therefore, is not available as a guide in the settlement of the claim, the insured is entitled to such lessening in the value of his property as is attributable to the unrepaired damage. When partial repairs are made, the insured is entitled to their cost, less allowable deductions, plus the depreciation resulting from that part of the damage that remains unrepaired. If the ship is sold in her damaged state, it has been held that the amount recoverable is her value before the casualty, less the amount for which she sold. If a sale of the damaged property is effected, the burden rests upon the insured to show that the full value of the salvage is realized.

Average clauses are not unusual in hull policies. In some policies it is made a condition that the insured bear a part of each loss, the deduction being referred to as "deductible average." Again, it is sometimes provided that there will be no liability unless the damage amounts to a designated percentage of the value, being an application of average limitation to the hull, or, as is sometimes the case, to a separate part thereof.

The Inchmaree Clause. One of the most famous decisions affecting the liability of the insurer was in the case of the steamer, "Inchmaree." The case involved damage resulting from the inadvertent closing of a valve. Upon appeal to the House of Lords it was held that, whether due to negligence or accident, such losses were outside the scope of the insurance and that they were not covered. To counteract the effect of this decision, and to provide indemnity for the insured for damage to the hull or machinery resulting from negligence of the master or crew, as well as from explosion or latent defects, a machinery clause, more commonly known to insurance underwriters as the "Inchmaree Clause," was introduced into hull policies. This clause adds new perils to those incorporated in the marine policy and

is made a part of the hull policies insuring steam vessels, or others using machinery, in order that the coverage may be complete. It reads as follows:

This insurance also especially to cover (subject to the free of average warranty) loss of, or damage to hull or machinery, directly caused by accidents in loading, discharging or handling cargo or caused through the negligence of Master, Charterers, Mariners, Engineers, or Pilots, or through riots, explosions (whether on board or ashore) bursting of boilers, breakage of shafts, or through any latent defect in the machinery or hull, provided such loss or damage has not resulted from want of due diligence by the Owners of the Ship, or any of them, or by the Manager. Masters, Mates, Engineers, Pilots, or Crew not to be considered as part owners within the meaning of this clause should they hold shares in the steamer.

The reference to latent defects has given rise to some confusion. Claims have been made for losses due to latent defects when such defects have been discovered. The courts have held that it is not the intention of the Inchmaree Clause to indemnify the insured if a latent defect makes its appearance without itself being the cause of loss or damage. If damage is caused by such a defect, even though the defect existed before the inception of the coverage, such damage is covered. If the defect itself is discovered, the insurance assumes no responsibility for the cost of its correction.

Partial Cargo Losses. When certain items of a cargo are totally destroyed, the loss is determined in the case of a valued policy by arriving at a figure determined by the proportion that the part lost bears to the value of the whole. Thus, if 5,000 barrels of potatoes are insured for full value at $10,000, and 1,000 barrels are totally destroyed, the loss is 20 per cent of the insurance. In the same case, if the policy is not written on a valued form, the indemnity is the insurable value of the destroyed or lost property measured by the invoice or cost price, plus freight, insurance, and charge. If the goods are delivered at their destination in a damaged state, the difference between the sound and the damaged values at the port of arrival is determined. If the policy is valued, the amount of damage is reduced to a percentage and applied to the valuation as fixed by the policy. To illustrate the operation of this rule, assume that the potatoes in the foregoing example were insured for the full gross value, so that with no change in the market at the point of destination their wholesale value would be $10,000. Assume a 30 per cent decline in

market value while in transit. The gross value of the goods is now $7,000. Further assume a partial damage, so that when the goods are sold they bring but $5,600. The difference represents 20 per cent of the gross value, and the loss is therefore a 20 per cent loss. Since, however, both insurer and insured in the absence of evidence of fraud are bound by the valuation written into the policy, the percentage thus determined is applied not to the gross value of the goods in the undamaged state in the market in which the damaged property was sold, but to the valuation expressed in the policy. While the difference between the price obtained for the damaged goods and $10,000 is $4,400, and the difference between the price obtained and the market value of the goods in sound condition is $1,400, neither figure represents the amount for which the insurers are liable. This amount is 20 per cent of the value written into the policy, or $2,000.

The Memorandum Clause. It was early recognized by marine underwriters that certain types of goods were extremely susceptible to small losses which, under the broad coverage of the marine policy, subjected the insurer to liability for the damage. If such losses were to be paid, the rate would have to be correspondingly increased; but in addition to this the line between loss and no loss was not an easy matter of determination. The problem was solved in the early days of marine underwriting by attaching to the policy a note or memorandum designating certain goods upon which the underwriter was relieved of all partial loss, and others less susceptible to damage on which no loss was to be paid unless the damage amounted to a certain percentage of the value.

The memorandum is no longer attached to the policy in the form of a note but is inserted in the body of the contract in the form of a clause. The old terminology continues in use, however, and the risks mentioned in the clause are termed "memorandum risks," and we refer to "memorandum articles" and "memorandum rates."

The clauses in use today are by no means uniform, some being short and in general terms, and others being extended and more specific. Below is an example of a memorandum clause to be found in an American cargo form:

MEMORANDUM. It is also agreed, that bar, bundle, rod, hoop and sheet iron, wire of all kinds, tin plates, steel, madder, sumac, brooms, wicker-ware and willow (manufactured or otherwise), straw goods, salt, grain of all kinds, rice, tobacco, Indian meal, fruits (whether preserved or otherwise), cheese, dry fish,

hay, vegetables and roots, paper, rags, hempen yarn, bags, cotton bagging, and other articles used for bags or bagging, pleasure carriages, household furniture, skins and hides, musical instruments, looking-glasses, and all other articles that are perishable in their own nature, are warranted by the assured free from average, unless general; hemp, tobacco stems, matting and cassia, except in boxes, free from average under *twenty per cent.*, unless general; and sugar, flax, flax-seed and bread, are warranted by the assured free from average under *seven per cent.*, unless general; and coffee, in bags or bulk, pepper, in bags or bulk, free from average under *ten per cent.*, unless general. Profits warranted free from claim for general average, but subject to the same per centum of partial loss as if the insurance were on goods. In case of total loss of profits be claimed, the Underwriters to be entitled to a credit of the same per centum of salvage as if the insurance were on goods, and in case of contribution in General Average for any portion of the goods at the customary sound value, this Company to be free from claim for loss on such portion. Not liable for loss on or damage to any goods shipped on deck.

In connection with the foregoing it is important to notice that when a loss must equal a certain percentage of the value before liability exists, the claim is paid in full without deduction if there is a liability. This is a case of average limitation. No exemption is made in the memorandum clause for general average claims.

Partial Loss of Freight. A partial loss of freight may be the result of a partial loss to either ship or cargo, or both. The measure of indemnity is determined by finding the proportion that the lost freight bears to the freight at risk. The percentage thus found is applied to the insurable value, in the case of an unvalued policy, and if the policy is valued, to the amount stated in the contract.

The following are indicative of the types of partial freight losses. If a voyage is divisible into parts, and freight is earned at the termination of a part, the percentage of loss sustained, if the ship is lost and the freight for the voyage is covered, is determined after allowing the insurer credit for so much freight as is earned. If part of the cargo is lost so that it cannot be delivered to its destination, there is a total loss of part of the freight. If the goods are delivered, though damaged, the freight is collectible, and there is no loss. If, because of a peril insured against, the voyage is discontinued and but a part of the freight collected, the difference represents a loss.

Loss Adjustment. The adjustment of marine losses involves a considerable degree of technical knowledge and, accordingly, is usually entrusted to professional experts. The adjuster is presumed not to represent any particular interest but to effect an equitable ap-

portionment of the loss. His adjustment is not binding until made so by agreement, but it serves in practice as the basis of settlement.

In order to establish a claim under the policy, it is necessary to present certain information which is obtainable from existing documents. As a source of proof that the loss was caused by one of the perils insured against, reference may be made to the log of the vessel. Here it would be expected that an entry would give proof of the circumstances surrounding the loss. The same information is available for use in establishing a claim which, when incorporated in a document made by the master under oath, is termed the "master's protest." In the case of a particular average claim on a cargo, the bill of lading is presented to show that the goods on which the loss is claimed were actually aboard the ship in question. The invoice of the goods serves as a basis for arriving at the value of the shipment and of determining whether or not the insurance is adequate. The insurance policy or certificate is necessary in order to determine to whom the loss is payable, and in the case of a hull loss, the certificate of enrollment showing ownership is essential. Having established a loss caused by a peril insured against and having furnished evidence of interest in the subject of the insurance, the claimant is then entitled to payment within thirty days.

Presumption of Loss. In the absence of unusual circumstances, such, for example, as the existence of war perils, if the ship has not been heard from after a reasonable time it is presumed that she is lost. If the vessel was seaworthy upon sailing, and there is no evidence to indicate the opposite condition, there is a presumption of law that she was lost by reason of some peril of the sea. If the insurance policy covers perils of the sea, there is a presumption of an actual total loss, and claim may be made therefor without the formality of abandonment.

The courts have held that there is no fixed time by law after which a missing vessel should be presumed to be lost. The length of time necessary to elapse must of necessity depend upon the circumstances in each case. When there has been no word or trace of a vessel for a period sufficiently long to make it appear certain that she is lost, the vessel, her speed, her facilities for communication, the voyage, and other like factors being duly considered, then the presumption of loss arises. In England, a notice of missing vessels is posted at Lloyd's, and ten days thereafter claim may be made upon the insurers for

total loss. In this country, thirty days may run after the presumption arises before the payment for loss is due.

War Risks. For a long time the clause, "men-of-war, enemies, letters of mart, and counter-mart, surprisals, takings at sea, arrests, restraints and detainments of all kings, princes and peoples of what nation, condition or quality soever," remained in the policy without particular significance as affecting the risk because of the absence of war perils. Policies as written during a period of hostilities recognize the war perils, and these are regarded as an important part of the risk. Policies are now written eliminating war risks, so if the war risk hazard is to be covered it must be made a separate transaction.

The following is an example of an American cargo policy:

Touching the adventures and perils which the said assurers are contented to bear and take upon themselves in this voyage, they are of the seas, fires, pirates, rovers, assailing thieves, jettisons, criminal barratry of the master and mariners (unless the assured on cargo be owner of or interested in vessel in whole or in part), and all other like perils and disasters, that have or shall come to the said goods and merchandises, or any part thereof. No risk while in warehouse or elsewhere on land is covered by this policy unless expressly agreed in writing. If this policy shall be extended to cover risks of inland transportation and/or risks on land, then in such cases it is understood that such inland transportation is by railroad only (unless agreed in writing), and that this insurance covers only loss or damage arising from fire, collision, derailment and floods (meaning rising navigable waters) while on railroad cars, and by fire or flood (meaning rising navigable waters) while on dock, wharf, pier, quay or elsewhere on land, unless otherwise agreed in writing. AND in case of any loss or misfortune, it shall be lawful and necessary to and for the assured, his or their factors, servants and assigns, to sue, labor and travel for, in and about the defence, safeguard and recovery of the said goods and merchandises, or any part thereof, without prejudice to this insurance; nor shall the acts of the assured or insurers, in recovering, saving and preserving the property insured, in case of disaster, be considered a waiver or an acceptance of an abandonment; and to the charges whereof the said insurance Company will contribute in proportion as the sum hereby insured is to the whole sum at risk.

Other policies leave mention of the perils which grow out of war in the contract but eliminate them by endorsement through the use of the "free of capture and seizure clause," known in the insurance business as the "F.C. and S. clause," which reads as follows:

Warranted free of capture, seizure, arrest, restraint or detainment, and the consequences thereof or of any attempt thereat; also from the consequences of hostilities or warlike operations, whether there be a declaration of war or not,

civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or *piracy*.

The use of the F.C. and S. clause definitely eliminates the question of liability of underwriters for loss or damage growing out of war or a state of war. It follows, therefore, that with the use of the F.C. and S. clause an insured who wishes his ship or goods to be protected against the perils of war must provide specific insurance covering these hazards, and this is the custom today.

The ocean marine policy covering perils of the sea includes such perils as sinking, collision damage, stranding, damage from storms, and as well includes fire damage. These particular hazards are increased during wartime because of the necessity to run without lights, removal of guides to navigation, danger of collision in convoys, and the like. Even though the increase in hazard was due to war, for many years it was held that such increase was not to be regarded as war risk within the meaning of ocean marine war risk insurance. War risks included only cover against losses caused by acts of an enemy such as torpedoing, bombing, and damage from shell fire.

A change in the direction of thought was evidenced following the Coxwold case, decided in England in May, 1942, on appeal to the House of Lords. This decision hinged upon interpretation of the F.C. and S. clause. If the American courts should follow the line of reasoning of this decision many risks, heretofore regarded as marine risks in this country, would be brought into the war risk category. In the light of the American decisions there was considerable uncertainty as to what the attitude of the American courts would be. The reasoning behind the decision in the Coxwold case seemed logical, and American underwriters eliminated doubt by amending in June, 1943, the war perils clause to include certain losses resulting from wartime conditions, such as: collision in convoy; collision resulting from vessels running without lights; stranding occasioned by removal of lights; buoys or other aids to navigation; or by navigating without a pilot. Simultaneously, these perils were excluded from the marine policy by the revised F.C. and S. clause.

War Risks Perils Clause. Although if the insured intends to cover war risks it is now the custom to use a separate policy, this is not mandatory, and occasionally the marine contract is endorsed to provide protection for war risks. In 1938, American marine underwriters generally discontinued including war risks in the marine con-

tract and adopted a separate policy form that is now, with some modifications, generally accepted. Because of the possibility of question as to the nature of a loss, it is still regarded as the best insurance practice to have the marine policies and the war policies on a given risk covered by the same insurer. The perils clause is positive and indicates specifically the extent of the cover. The following clause now appears in the American policies:

> This insurance is only against the risks of capture, seizure, destruction or damage by men of war, piracy, takings at sea, arrests, restraints and detainments and other warlike operations and acts of kings, princes and peoples in prosecution of hostilities or in the application of sanctions under international agreements, whether before or after declaration of war and whether by a belligerent or otherwise, including factions engaged in civil war, revolution, rebellion or insurrection, or civil strife arising therefrom, and including the risks of aerial bombardment, floating or stationary mines and stray or derelict torpedoes; but excluding claims for delay, deterioration and/or loss of market, and warranted not to abandon (on any ground other than physical damage to ship or cargo) until after condemnation of the property insured. Also warranted not to abandon in case of blockade, and free from any claims for loss or expense in consequence of blockade or of any attempt to evade blockade; but in the event of blockade, to be at liberty to proceed to an open port and there end the voyage.

Because of changes in circumstances that may take place almost instantaneously, cargo war risk open policies make provision for cancellation upon forty-eight hours' notice. When cancellation notice is given, if the insurers are willing to cover the risk on new terms, notice to this effect is ordinarily tendered with the cancellation notice. If shippers already have shipments afloat or in course of being loaded when notice is given, cancellation does not apply with respect to these items. Premium charges are made as of the date of sailing, though in some circumstances rates may be fixed several days in advance.[4]

The Water-Borne Agreement. The custom of writing marine insurance contracts on cargoes to attach at some point ashore and to terminate ashore at the point of destination introduced hazards, not contemplated when the practice was instituted, when shipments involved land hazards in belligerent countries. To eliminate the war

[4] Indicative of the violent fluctuations in cargo premiums following the attack upon the United States by Japan on December 7, 1941, cargo rates in the Pacific that were hitherto 5 cents per hundred were immediately quoted at $4.00 per hundred. Lloyd's announced that it would discontinue accepting cargo risks until further notice.

risk hazard ashore when open or floating policies are written covering war risk hazards, the so-called "water-borne agreement" is attached to the policy. Under the terms of the agreement, war perils are covered only when the goods insured are on an overseas vessel. The limitation is set forth in the policy in the following terms:

(A) The insurance against the said risks shall not attach to the interest hereby insured or to any part thereof

(I) prior to being on board an overseas vessel, (For the purpose of this Clause an overseas vessel shall be deemed to mean a vessel carrying the interest from one port or place to another where such voyage involves a sea passage by that vessel)

(II) after being discharged overside from an overseas vessel at the final port of discharge

or

after expiry of 15 days counting from midnight of the day on which the overseas vessel is safely anchored or moored at the final port of discharge, whichever shall first occur,

(III) at a port or place of transhipment to another overseas vessel after expiry of 15 days (counting from midnight of the day on which the overseas vessel entering with the interest is safely anchored or moored) until the interest is on board the oncarrying overseas vessel.

The clause was primarily designed to meet conditions that developed in World War II. With the termination of hostilities, interest in the clause now is only academic. On and after July 1, 1945, members of the American Institute of Marine Underwriters commenced to broaden the period of coverage under the cargo war risk policies to include war risk insurance while on land. The willingness or ability of marine underwriters to extend war risk coverage depends entirely upon the insurable nature of the risk.

Frustration Clause. During World War I, a decision of the House of Lords, known as the "Sanday case," held underwriters liable in the case of loss of voyage or frustration of voyage if it could not be completed because of orders of a government authority. In rendering judgment in the House of Lords, Lord Loreburn stated:

I am not pressed by the circumstance that force was neither exerted nor present, for force is in reserve behind every State command. It would be a strange law which deprived the assured, if otherwise entitled to his indemnity, upon the ground that he had not resisted, till the hand of power was laid upon him, an order which was his duty to obey. If it were an order which he was not bound to obey and which he might have successfully resisted either by violence

or by process of law, a question might arise whether or not there had been in fact a restraint. But that is outside the present case.[5]

It was the opinion of the Lords that not only the thing insured but the voyage for which it was insured together formed the subject matter of the insurance, and, therefore, the insurance covered against loss by frustration of the voyage.

This decision was far-reaching in its effects and resulted in the development of another clause for attachment to the policy when insurers were prepared to cover war risks but not losses which amounted to a loss of market owing to inability to complete the voyage. In such instances, the following or a similar clause is made a part of the policy covering war risks: "Warranted not to abandon (on any ground other than physical damage to ship or cargo) until after condemnation of the property insured." This clause has the effect of limiting losses such as that allowed by the Sanday decision but permits a claim when the property is in fact a loss, the outgrowth of condemnation. The insured is required under the sue and labor clause to co-operate in securing the release of the goods; and if the goods are released, the limit of the insurer's loss is the extra expense incurred in reaching destination, including legal expenses in effecting the release.

If captors sell the goods, as they frequently do in the case of perishables, even though later as result of prize court findings the value is returned to the owner, it is held that if the sale is made without the consent of the owner he may, as insured, claim a total loss, assigning his right to proceeds, if any, to the insurance company.

American War Risks Syndicates. The important war risk lines are written by groups of marine underwriters known as "syndicates." The American Marine Insurance Syndicate "C" covers hull risks, and the American Cargo War Risk Reinsurance Exchange covers cargo risks.

Syndicate "C," composed of a large group of marine underwriters, was formed following World War I at the instigation of the United States Shipping Board. This group underwrites risks presented by brokers and has, it is stated, a capacity for insuring up to $4,000,000 on any one vessel.

To handle cargo risks, pursuant to section 29 of the Merchant

[5] *British and Foreign Marine Insurance Company* v. *Sanday (1916),* 1 A.C. 650; 85 L.J.K.B. 550; 114 L.T. 521; 32 T.L.R. 266; 60 Sol. Jo. 253; 21 Com. Cas. 154; 29 Dig. 276, 2236.

Marine Act of June 5, 1920, the American Cargo War Risk Reinsurance Exchange was organized. The Exchange commenced operations in June, 1939, when it became apparent that threatening war in Europe would inevitably require co-operation in the insurance market to provide adequate capacity for the war risk needs of American business. The Exchange provided a reinsurance pool which required all subscribers to reinsure therein 100 per cent of all direct war risk liability. All marine insurance companies doing business in the United States were invited to become members of the pool. As the pool developed, the participation of each company was fixed on a percentage basis. The total of the percentage liability of all participants aggregated 100 per cent. The effect of this plan was to create a distribution of all war risks among all the members of the pool in accordance with the participation of each member company. This enabled marine insurance companies to assume, without question, direct obligation for huge risks, with the knowledge that the risks were fully reinsured to the extent of the total resources of the participating insurance companies. Virtually all the marine insurance companies doing business in the United States, with combined assets of over a billion dollars, subscribed to participate in the business of the Exchange.[6]

Strikes, Riot, and Civil Commotion. It is generally clearly understood that the marine policy in the ordinary course does not include losses growing out of strikes, riots, or civil commotion. When war risks are assumed, the situation is less clear, and when it is not intended to include losses from this source within the war risk cover, it is usual to incorporate a clause known as the "R. and C.C. clause," which provides: "Warranted free of loss or damage caused by strikers, locked out workmen, or persons taking part in labor disturbances, or riots, or civil commotions."

As in the case of goods in storage on land, the riot and civil commotion hazard is a very real one. This hazard, of course, exists entirely apart from the war risks hazard. In time of peace, when goods may be shipped insured under policies which contain the warehouse to warehouse clause, it is quite possible that losses might develop resulting from the action of strikers, locked-out workmen, or other

[6] For a discussion of the participation of the government in ocean marine insurance during World War II see Magee, J. H., "The Position of the Government as an Insurer of Ocean Marine War Risks," *Journal of the American Association of University Teachers of Insurance*. Vol. X, No. 1, (March, 1943), p. 46.

persons involved in riots or civil conflicts. The marine policy does not cover this hazard, but the risk may, of course, be written when specifically accepted by the underwriter and made part of a special agreement incorporated in the contract.

FOR REVIEW

1. What are the York-Antwerp rules, and are they legally binding upon American shippers?
2. The laws of average and jettison are said to be very old. Discuss.
3. It is the custom for ocean-going steamships to secure the services of a pilot before leaving the port of X. The captain of the "Tindal" undertakes to bring his own ship out of port without availing himself of the services of a pilot. There is nothing in the insurance policy with reference to the use of a pilot. Is the omission then important from the standpoint of the insurance?
4. Captain X in a foreign port signals for a pilot. B answers the signal and falsely represents himself to be a pilot capable of bringing the ship safely into port. Because of his incompetence the ship is stranded. Have the insurers grounds for denying liability?
5. The "Nancy" sailed from Rockland, Maine, in 1816 and was never heard from. The insurers denied liability, contending that she was lost because she was unseaworthy. Did they have a case?
6. The "Silva" became so disabled at sea as to become unseaworthy. The captain, to save time, refused to put into port for repairs. The ship was later lost. Its owner contended that the ship was seaworthy when she sailed. The insurers denied liability. Can the owner collect for the loss?
7. X insures a ship believing it to be seaworthy, but when it sailed several members of the crew were left ashore. What effect has this upon the insurance?
8. X, a broker, effected a policy at Lloyd's covering upon an overdue ship. At the time the insurance was effected there was an unopened letter in his possession stating the ship to be lost. In your opinion are the insurers liable?
9. B, an agent, wrote a letter applying for insurance, but before it was mailed learned that the vessel he wished to insure was lost. B sent the letter and did not communicate the information he subsequently received to the insurers. Since he did not possess the information when the letter was written, B contended that he need not go beyond the letter in advising the insurers. What is your opinion?
10. In issuing a marine policy the name of the ship was incorrectly inserted in the form. The correct name of the ship was the "Adventure," but the policy read the "Ventura." Claim is made for a loss and the insurers deny liability. Have they a case?
11. The rigging of a ship has been badly damaged as the result of a severe storm at sea. Claim is made to the underwriters for loss on the ground that the damage was caused by "perils of the sea." Is the loss collectible?
12. To save a ship, a certain part of the cargo is jettisoned. In opening the hold,

water destroyed a substantial part of the remaining cargo. May the owner of the damaged goods make a general average claim as a result of the water loss?

13. In the case of jettison, has the shipper any recourse for the loss of freight occasioned by the necessity of throwing over part of the cargo?
14. If a sword fish drives its sword through the plank of a wooden ship, is the damage a collectible loss under a marine policy covering against "the perils of the sea"?
15. Lord Bronwell suggests the following definition of "perils of the sea": "Every accidental circumstance, not the result of the wear and tear, delay, or the act of the assured, happening in the course of the navigation and incidental to the navigation, and causing loss to the subject matter of the insured." In the light of this definition, would you interpret the loss of a ship at sea by fire to be covered under a policy insuring against "perils of the seas"?
16. A supply of meat was shipped at Hamburg aboard the "Leopard." The meat became putrid and was thrown overboard. The loss was occasioned by unusual delays which in turn were the results of bad weather. Is this a loss occasioned by "perils of the sea"?
17. A steamer with her machinery, including a donkey engine, was insured by her owner. The donkey engine was used to pump water into the main boilers. A valve was inadvertently closed, and the engine was damaged. The closing of the valve was not the outgrowth of any action of the sea, yet it caused a substantial loss to the owners. Does the marine insurance policy afford protection?
18. When the "Ellaine" was built a defective steel frame was cast and put into the vessel. The defect was concealed by the builders through the use of metal and a steel wash. The defect, when discovered by the owners, was reported to the insurers, and a claim was filed on the ground that the loss fell within the coverage of the Inchmaree Clause covering loss or damage "through any latent defect in machinery or hull." Does the clause cover this loss?
19. A shipload of refrigerated supplies was in danger of being frozen in. To save the loss, part of the cargo was transferred to land and shipped to its destination. None of the goods was lost. Are the marine insurers liable for the extra cost?
20. The captain of the "New York" reports in his log that on the night of April 16, the ship touched bottom on a sand bar. The owners of the cargo contend that they are justified in filing a particular average claim on the grounds that the ship stranded. What is your opinion?
21. Marine insurance, it is generally understood, undertakes to provide insurance against "perils of the sea." There are circumstances when the attendant "land coverage" may involve risks such as to call for rates entirely out of line with the normal expectation for a sea voyage. Discuss.

CHAPTER XXII

OCEAN MARINE INSURANCE (*Continued*)

POLICIES Adapted to Interest and Coverage. While certain fundamental principles of law apply to the business of marine underwriting, because of the wide variety of interests to be covered and the needs of different classes of marine adventures, numerous policy forms have been developed. Fundamentally, they have much in common. It is necessary, however, to note some of the more important differences and the needs for which the forms have been developed.

Because in the United States no standard form is required by law, basic policy forms have been drawn and adopted by the insurance underwriters. These policies are based upon the old Lloyd's form and are the same in their essentials. Because, however, they are not absolutely alike, it is not safe to assume that policies issued by different companies on similar interests afford identical coverages. All policies should be carefully checked by one familiar with the forms and the terminology of marine insurance.

Time Policies. Marine policies are issued either for a definite period of time, as is the case of fire policies, or to cover a designated voyage. When the ownership of the insurable interests tends to permanence, the time policy has certain advantages; paper work in effecting insurance for separate voyages is eliminated, as is the responsibility for effecting the renewal of insurance that expires at no regular and predetermined date. Vessels operating the year around on regular runs are normally covered by the time form.

There is, strictly speaking, no particular limit to the period for which a time policy may be written. The term may be for a year, or for a shorter period, the limitation for a year following by custom the statutory requirement of England.

Voyage Policies. Voyage policies differ from time policies in that their termini are geographical instead of temporal. The risk is insured during a designated voyage, and the port of departure and the port of destination serve as a basis to indicate the inception and termination of the coverage.

Cargoes, because they are in danger of destruction from sea perils

only during the period of transportation, are in the ordinary course insured under the voyage form. Although insurance on hulls is more usually written on the time basis, if the vessel is subject to unusual perils or is a tramp steamer operating over no particular route, voyage policies are sometimes more satisfactory.

In the case of voyage cargo policies, the insurance attaches "immediately following the loading on board," unless another point of attachment is designated. Coverage terminates when the goods are safely landed. Numerous modifications of this provision are common, such as insuring from warehouse to warehouse, in which case not only sea perils but also truck, railroad, dock handling, and perils of like nature are covered during transportation to and from the warehouses. Other less broad extensions are written, such as wharf risks for a designated number of days after the commencement of discharge.

Hull policies written "from" attach from the moment the vessel gets under way with the intention of proceeding on the voyage insured. When written "at and from," insurance attaches when the ship berths to load. The terminus is usually provided to be twenty-four hours after the vessel has arrived safely in port.

Open Cargo or Floating Forms. This form of contract covers from a designated time, but its termination may be, and usually is, indefinite and subject to notice by either party to the contract. The policy covers all shipments of the insured, subject to such limits as it may prescribe, within a designated geographical area. Amounts at risk are reported by the insured to the company from time to time, as information concerning them is received, and a further report is made when the shipment has arrived safely at its destination. The premium is computed upon the amounts at risk, as determined from the reports made to the company. All shipments are automatically covered as soon as made, whether known to the insured or not, provided always that reports are made as soon as possible.

When financial advances are made upon cargoes in transit, those who become parties to the transaction will require evidence that their interest is protected by insurance. Aside from special policies so written as to be assignable, the need is met by a privilege accorded the insured under the open form of issuing insurance certificates upon forms provided for the purpose. The form indicates the right of the named insured, or his order, to the insurance, and therefore it is to

the holder of the document properly endorsed that the underwriters are liable in case of loss. The major part of the cargo insurance today is written under open contracts, and by this means business transactions are speeded and simplified.

Blanket Policies. Insurance, somewhat similar to that afforded by the open policy, is provided by the blanket form. This policy is not a reporting form, but is written upon an estimate of the total coverage required during the policy term. The premium for the policy is computed upon the estimate of the total coverage required and is readjusted at the end of the policy term in accordance with the actual amounts at risk, as shown by the records of the insured. Consequently, if the shipments are in excess of the estimate, an additional premium is charged; if below, provision is made for a return premium.

Like the floating policy, the blanket form designates the classes of merchandise to be covered and indicates the geographical limits within which the insurance attaches. All goods at the insured's risk falling within the policy limits and description are covered.

Losses paid under this form impose an additional cost on the insured, inasmuch as he is required to reinstate the policy for the balance of the term by paying a pro rata premium on an amount equal to the loss.

Single Vessel and Fleet Policies. In the early days of American shipping, a vessel was owned jointly by a group of individuals or by a single individual. Frequently an owner might hold fractional parts of a number of ships, buying shares in vessels in much the same manner and for the same purpose that shares in stock companies are purchased today. Each vessel was insured separately as a single risk for the account of the owners, without regard to other vessels in which they might have an interest, and this is the common practice today.

With the advent of steamships and the development of large companies to operate fleets of vessels, it was found that insuring the fleet under a single coverage had certain advantages. The most important of these was the inclusion of the less desirable and older risks in the policy at an average rate. The poorer vessels, if they were offered individually, might be rejected altogether by the underwriters or accepted only at a very high rate. The effect, then, of the fleet policy is to provide coverage for the poorer risks at a lower rate than would be obtainable otherwise.

Ships operated as fleets, and ostensibly owned by one company, are frequently, as a matter of law, separately owned. This individual ownership is effected through the agency of the corporate form of business organization. A corporation is formed to hold each ship in the fleet, and another corporation formed to operate it. This legal device has the effect of limiting liability claims in cases of accident to the single vessel involved and places the other vessels of the fleet beyond the reach of claimants. Fleets organized on this basis call for the single vessel coverage.

Hull Average Clauses. Hull policies, in the interest of a lower premium, are written providing for either an average limitation or a deductible average. The average form most frequently to be found limits the liability of the insurer under a minimum franchise form. Ordinarily 3 per cent is used, but sometimes this is as high as 5 per cent. If a larger sum is required to indicate the minimum for which a claim may be made, it is common practice to eliminate percentages and instead to incorporate into the policy a lump sum figure.

When the deductible average form is used, any sum agreeable to the parties may be written into the contract. It may range from a few hundred dollars to hundreds of thousands, depending upon the risk and the amount of loss the insured is willing to carry. It is to be remembered that under deductible average, the deduction is made from any loss. Under the minimum franchise form no claim is made unless the loss reaches a certain limit, but if it reaches or exceeds the designated limit, it is paid in full.

Collision Liability. Maritime law makes a vessel liable for damage to property and injury to persons caused by a collision in which negligence may be fixed. Not only is the negligent vessel liable for damages to other vessels as a result of collision, but it is also liable for damage to piers, breakwaters, aids to navigation, and other property with which it collides.[1]

[1] Until the Sirovich bill, signed by President Roosevelt on August 30, 1935, had become a law, the liability of shipowners in the event of a marine disaster was limited to the value of their ships after the accident. Under the present law, not only has the limit of liability been extended, but the liability risk of the owners and operators of vessels has been materially increased. The law is the outgrowth of a marine disaster off the New Jersey coast in 1934 when a passenger steamship burned. In accordance with the then existing laws, the passengers and relatives of those lost were able to collect but comparatively small amounts as damages.

Under the present law, liability may be established if the action of the captain is such as to constitute negligence, or if ship's officers or officials of the company ashore knew of any unseaworthy condition which could have been corrected before the ship

The physical loss to the insured vessel is covered by the perils clause, but this does not extend to indemnifying the insured for losses growing out of his legal liability for injury to property or to persons. To provide this coverage, a collision clause is incorporated into most hull policies. This is, in effect, a separate contract entirely apart from the perils coverage and covers the insured's legal liability for property damage growing out of collision with another ship. Personal injuries are excluded from the coverage, as are injuries to wharves, aids to navigation, and the like.

Protection and Indemnity Clause (P. & I.). When the liability provided in the collision clause is considered not to be sufficiently comprehensive, it may be broadened by adding the so-called "P. & I. clause," which extends the coverage under the policy to include the insured's legal liability for damage to harbors, docks, wharves, buoys, and other similar properties that are excluded under the collision clause. If required, the clause is sometimes written to include personal injury and loss of life.

Total Loss Only Coverage. When for some particular reason partial losses are to be entirely excluded from the coverage, it is possible to secure insurance covering only in the event the vessel is a total loss. When the character of the risk is such that full cover insurance would be extremely high, the "total loss only" form may be more attractive in the light of the premium differential. The form may be written to include general average and salvage charges.

Builders' Risks. The hull builders' risk policy attaches from the laying of the keel and is usually written for a period of a year, or for the estimated period of construction. The coverage terminates upon the expiration date of the policy or, if the vessel is finished earlier, upon delivery of the completed vessel to the owner. The policy is written for the full contract price; otherwise, the insured becomes a coinsurer to the extent of the deficiency. Since the full contract

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left port. It is, therefore, impossible today for the owners of a steamship line to divest themselves of liability by attempting to place responsibility upon the officers in command of the ship. If negligence can be established, the company is liable up to an amount equal to the tonnage of the ship multiplied by $60 for each ton. In the event, however, that the negligence is the outgrowth of unseaworthiness known to the officers of the ship or officials of the line prior to the time the ship sailed from port, the entire assets of the owners may be reached to satisfy damages. The Sirovich bill further provides that passengers have six months in which to file notice of injury and a year in which to bring legal action.

See "The American Ship Owners' Limitation of Liability Statutes, as Amended by the Acts of August 29, 1935, and June 5, 1936."

price must be insured from the inception of the risk, an average rate is made for computing the premium. In arriving at this rate, the specific fire rate of the yard, its record, the policy term, perils to be covered, and material to be used are all considered.

In addition to covering on the hull itself, the policy covers tackle, apparel, ordnance, munitions, artillery, engines, boilers, machinery, boats, and all furniture and fixtures, as well as all material in the yard, buildings, workshops, on docks, quays, pontoons, and the like, to be used in the work of construction. The policy is nearly an all-risk contract, covering against fire from the time of the laying of the keel until delivery and including the risks of launching and trial trips, if required. General average and salvage charges are covered, together with the liability risks assumed under the collision and the P. & I. clauses. Exempted are claims originating in loss of life and personal injury whatever the cause, including claims under workmen's compensation or employers' liability acts; war risks; strikes; riots; civil commotions; consequential damage through delay; and damage to boiler, engines, and material while in transport, except in the port where the construction is taking place.

In case of any failure in launching or damage to the ship through mishap, the underwriter is liable for the loss thus occasioned. If damage develops during the trial trip after a successful launching, the underwriter is liable unless some exception is made, such as the exclusion of loss to a warship caused by tests of armament. If, however, some ordinary mishap occurs during the trial run, causing a considerable overhaul expense to effect a correction, the insurer must pay the costs.

If the work is completed before the expiration date of the policy, a return premium is paid the insured upon the cancellation of the contract, it being provided, however, that in any case the underwriter is entitled to an agreed minimum premium. If the work is not completed upon the expiration of the policy, provided notice is given the company prior to expiration, the policy may be extended for an additional premium, computed monthly on a pro rata basis.

Pleasure Craft Insurance. The number of hulls engaged in commerce is small, compared with the number of motorboats and yachts owned privately and used solely for pleasure purposes. Marine insurance is written on private yachts and motorboats upon a broad form designed to meet the insurance needs of the owners of such craft.

For a term of one year, time policies are written covering hull, spars, sails, materials, fittings, boats, furniture, provisions, stores, machinery, and boilers. If new, boats are valued at their purchase price; if secondhand, at cost, plus improvements. The policy is valued, and full insurance to value is required.

The policy covers damage to the insured vessel caused by perils of the sea and other waters described, fire and other perils usually found in the marine policy, including general average and salvage charges. The Inchmaree clause and the collision clause are made a part of the policy. Exclusions include: pilferage; war risks; strikes; riots and civil commotions; loss on account of any illicit trade; damage to sails, spars, or masts sustained while racing; loss of tender while in tow; liability for personal injury and for damage to docks, buoys, and other property not included in the coverage of the collision clause. Partial losses are covered in full if equal to the franchise expressed in the policy, which is usually 1 per cent, and when repairs are necessitated no deduction is required "new for old."

Certain cruising limits are designated in the policy, and to leave these limits without consent of the insurer constitutes a deviation and voids the policy. Forms usually provide for automatic reinstatement if the insured vessel returns to the cruising limits undamaged. If furniture, tackle, or other property of the vessel is stowed ashore, apart from the vessel itself, the property is covered against fire only, and the amount applying on the property is deducted from the amount covering the yacht and property on board. On the values thus covered ashore a limit is usually set at 10 per cent of the insured value of the vessel.

Yacht Protection and Indemnity Insurance. In order to secure more adequate protection than is afforded by the collision clause, the yacht owner may have his policy endorsed with a protection and indemnity rider, of which two forms are usually written. The one form includes liability for loss of life and personal injury, while the other covers only property damage. The customary coverage is the same as the amount insured on the hull, with a specified limit for each individual claim for personal injury. Larger amounts of insurance than a limit set by the hull value are obtainable by the insured when desired.

The policy covers the insured's liability for damage to any interest

whatever on or to another ship, caused by the insured ship "proximately or otherwise" in so far as the coverage is not afforded by the collision clause. The P. & I. clause then provides extension of the coverage to claims against the insured for damaged goods, merchandise, and other interests ashore and for loss to any harbor, dock, pier, stage, buoy, telegraph cable, or any other property, however caused. Finally, the policy covers any liability for damage originating in a wreck of the insured vessel and for loss of life or personal injury. The policy specifically excludes workmen's compensation claims, but these may be assumed by special endorsement.

Longshoremen's and Harbor Workers' Compensation. Under the terms of the Longshoremen's and Harbor Workers' Compensation Act, being Federal Act No. 803, passed by the Sixty-ninth Congress and approved March 4, 1927, every employer is obligated to secure the payment of compensation, either by insurance or by qualifying as a self-insurer for the "disability or death of an employee resulting from an injury occurring upon the navigable waters of the United States (including any dry dock), if recovery for the disability or death through Workmen's Compensation proceedings may not validly be provided for by State Law." This requirement does not extend to include the master or crew of any vessel. Failure to secure payment of compensation carries with it a penalty of a fine not more than $1,000, or by imprisonment for not more than one year or both.

The subject of workmen's compensation and employers' liability insurance is to be noticed at some length in the discussion of casualty insurance. An insured, however, who might have no occasion otherwise to carry compensation insurance might overlook the liability placed upon him by the federal act mentioned above. Since the insured's liability under this act may be endorsed upon the fire and marine policy extended to cover P. & I. risks, it is important to indicate at this point the coverage which is essential to the insured who wishes his liability for personal injury fully covered.

Fire Coverage for Yachts and Motorboats. Policies are issued covering private pleasure yachts or motorboats against the risk of fire only. Strictly speaking, the policy is a fire coverage rather than a marine risk. The insurance is written on the standard fire insurance policy, to which the marine departments of the insurers issuing the policy attach a special form covering the vessel ashore or afloat. If

the vessel is not afloat at least part of the year, it is out of the jurisdiction of marine underwriters and is rated and written as a straight fire risk.

The same method of valuation is used as in writing other marine coverages on a yacht hull; that is, the cost price if new, or the cost plus improvements if secondhand. The 80 per cent coinsurance clause is customary. The form provides cover not only for hull, motors, and machinery, but also for ballast, spars, sails, rigging, boats, charts, furniture, fixtures, linen, silver, nautical instruments, and provisions and supplies of every description while on board the insured vessel.

The usual protection against direct loss or damage by fire is provided, as well as that against direct damage caused by lightning, but protection against tornado, cyclone, or windstorm is excluded. The other restrictions usual to the fire policy apply, such as excluding from coverage: bills and currency; electrical damage to motors and other electrical apparatus; and losses caused by invasion, insurrection, riot, usurped power, theft, or neglect of the insured to preserve the property when endangered.

The policy, like marine yacht forms, covers a percentage, usually 10 per cent, of the property when stowed ashore. Permission is given to use and carry gasoline for generating power, to use kerosene, alcohol, and electricity, and to carry guns and ammunition for sporting purposes or for saluting. Cruising limits are specified, and permission is given to haul out and go out of commission or to go into dry dock for alterations and repairs.

Cargo Shipments. The great bulk of cargo shipments are insured under open policies. To accommodate the occasional shipper a voyage policy covering single shipments is available and is referred to as a "trip-transit policy," or a "single-risk certificate."

In connection with cargo shipments it is important to recognize that for insurance purposes goods are divided into two classes—approved and unapproved. In the first group is included merchandise not particularly susceptible to damage, either because it is well packed or because of the nature of the goods. Most manufactured articles and new merchandise are found in this group. In the unapproved group are found used merchandise and goods particularly susceptible to sea damage, such as green fruit, cement, and the like.

To different classes of merchandise different terms of average are made to apply, and there are special classes involving special risks with a franchise clause adjusted to meet the particular need.

It is important, likewise, to recognize that in the transportation of merchandise, a considerable portion of the risk insured against arises because of perils while the goods are on land or on land conveyances. The extent to which a marine policy may be extended to cover land risk is illustrated by the contract used in insuring cotton grown in this country. The policy covers the ginned cotton from the time it is weighed until it is delivered at the mill of the consignee in Europe or in the cotton-using countries in Asia. Thus, the cotton of the insured, while it is in transportation on land, while it is in warehouses, while it is being graded and rebaled, and while it is being transported and handled in the foreign country, is at the risk of the insurer for the named hazards. This type of business is virtually nonexistent during a conflict such as that of World War II. Cargo risks as a rule do not involve so extensive a land coverage, but when a part of the trip involves land handling, it is important to note whether the policy covers the necessary perils.

Perils Clause. The usual clause recites the perils covered while the goods are water-borne and then adds the perils insured while they are on shore or land conveyances. The basic marine policy before modification provides that while the goods are water-borne they shall be insured against "perils of the sea, fire, pirates, rovers, assailing thieves, jettison, criminal barratry of the master or mariners, and all other like perils and losses, and misfortunes that have or shall come to the hurt, detriment, or damage of the said goods and merchandise, or any part thereof." General average, salvage charges, and accidental explosion are also covered. While the goods are on shore or land conveyance the perils insured against are: "fire, rising navigable waters, collapse and/or subsidence of docks or wharves, collision, derailment, or overturn." Accidental explosion coverage is also included on land.

The policy does not cover loss of market, damage or deterioration caused by delay, war risks, loss due to illicit or prohibited trade, government restriction or embargo, strike, riot, or civil commotion. The interest of alien enemies is excluded as is "loss from dampness, change of flavor, decay, spotting, discoloration, or being musty or

moldy unless caused by actual contact with sea perils, breakage and/or leakage and/or loss of weight and/or loss of contents unless caused by stranding or collision with another vessel."

The policy is so drawn as to cover only actual physical damage to the subject of the insurance when that damage is caused by perils against which the insurance is written. Losses occasioned because of some inherent character of the merchandise, such as spontaneous combustion, even though it is fire, do not fall within the coverage. For this reason, to meet the requirements of the insured in particular instances, the coverage may be extended upon the payment of an additional premium. These risks include theft, pilferage, breakage, oil damage, steam or sweat of the vessel's hold, and damage from improper stowage and from contact with other parts of the cargo. Likewise, insurance may be provided against war risks, strikes, riots, and civil commotions, and occasionally certain commodities are covered under a comprehensive form against "all risks."

Shipments insured under open policies are not covered when shipped in sailing vessels or in wooden ships, whether steamers or sailing vessels. This condition is not burdensome, since wooden steamers or sailing vessels of any type are rarely found today in the business of carrying overseas freight. If in some unusual circumstance the use of a wooden ship or sailing vessel is necessary, to effect coverage all conditions surrounding the risk should be submitted immediately to the underwriters, who will indicate upon what terms, if any, the risk will be insured.

Single-Risk Insurance. When the business of the insured is not of an extent to warrant the use of an open policy, single risks may be afforded the same protection by placing insurance at the time of shipment. The procedure is not automatic. The owner of the interest to be insured must submit to the company a statement of the kind of merchandise to be insured, how it is packed, the places of shipment and destination, the name of the steamer, and the nature of connecting conveyances. Finally, the owner must indicate the perils against which he wishes coverage. With this information the company submits a rate, and not until it is indicated as acceptable is the risk bound. In due course, a single-risk certificate is issued and delivered to the insured. Policies of this sort are sometimes written before the insurable interest of the insured attaches. It is essential, however, that the insured be interested in the subject matter insured at the time of the

loss. Likewise, an assignee may recover on a policy even though he had no interest in the insurance when the policy was executed, provided that on the date of the loss he was entitled to both the policy and the goods.[2]

Export and Import Policies. Open cargo forms are written to cover either on imports or on exports. In either case, the basic policies are identical, being adapted to their particular purpose through the attachment of a suitable rider. The export or import rider, whichever applies, furnishes automatic protection to the insured on his goods at risk against the named perils, including coastwise and intercoastal shipments. The policy indicates the nature of the shipments to be covered and the geographical limits within which the coverage extends.

The export policy covers on all shipments made on and after the effective date of the policy. Shipments included are those made by the insured himself, or by others when the insured has received instructions to cover. By the terms of this policy the insured warrants to report all shipments promptly to the company and to pay premiums at agreed rates monthly.

The conditions of the import policy are essentially the same as those of the export policy, with the exception that the former policy is sufficiently broad to attach coverage even before the insured knows that the cargo is shipped. From the time it becomes effective, the policy attaches on all shipments consigned to the insured, or to other parties if an insurable interest exists in the insured. Likewise, coverage may be effected for other shipments than the insured's if the insured has been instructed to effect it. Since the importer does not have as complete a knowledge of cargo shipments as the exporter, he cannot furnish a report as promptly. Under the terms of the policy, he is obligated to report as soon as he receives notice of the shipment, or as soon thereafter as practicable. As in the case of the export policy, premiums are paid monthly.

Free of Particular Average (F.P.A.). Because the memorandum clause is not sufficiently specific to meet all situations, different forms of the "free of particular average" clause are used.

Merchandise shipped in the ordinary course is stowed under deck. Merchandise shipped on deck is never covered under an open policy, unless for some particular reason the policy is so written, or under a

[2] Eldridge, W. H., *Marine Policies* (London: Butterworth & Co., Ltd., 1938), p. 5.

single-trip policy unless so specified. When for some reason a special cargo is to be shipped on deck, the facts should be reported to the company and its consent thereto obtained. The customary average clause for such shipments is known as the "free of particular average American conditions clause" (F.P.A.A.C.). It includes a jettison and washing overboard clause and provides: "Free of Particular Average unless caused by the vessel being stranded, sunk, burnt, or in collision, but including jettison and/or washing overboard irrespective of percentage."

In the case of under-deck shipments, which form the greater bulk of cargo shipments, approved merchandise is ordinarily covered under the following clause: "Free of Particular Average under 3% unless the vessel be stranded, sunk, burnt, or in collision, each shipping package separately insured." Under this clause the company is relieved of the burden of paying petty claims. If the loss to any package equals 3 per cent, it is paid in full.

When merchandise is unapproved, the "free of particular average English conditions clause" (F.P.A.E.C.) is the average clause most frequently used. It reads as follows: "Free of particular average unless the vessel be stranded, sunk, burnt, or in collision." By the terms of this clause there is no liability on the part of the insurer for partial loss to the goods insured unless the vessel suffers one of the enumerated accidents.

The two forms of particular average clauses are similar in their terminology but quite different in their meaning. The free of particular average American conditions clause provides that partial loss is not covered by the policy unless the loss is caused by the stranding, sinking, burning, or collision of the vessel. Under the free of particular average English conditions clause the underwriters are liable if one of the casualties enumerated happens during the voyage, whether it is or is not actually the cause of the loss.

It is maintained that the English clause was intended to accomplish the result that actually is accomplished by the American clause, that is, the assumption of liability for partial losses only if caused by the named casualties. Court decisions have held that a partial loss happening at any time during the voyage and in no way connected with the specified casualties is covered merely by the happening of the casualty. This is due to the fact that the happening of the casualty has the effect of nullifying the average clause, restoring the original

policy conditions. Notwithstanding the fact that the American conditions clause accomplishes what all parties seemed in the beginning to intend, nevertheless the broader English conditions clause is more acceptable to the insured and is, therefore, in greater demand in this country and abroad. Following is the English clause that is widely used at the present time:

Warranted free from particular average unless the vessel or craft be stranded, sunk or burnt but notwithstanding this warranty the underwriters are to pay the insured value of any package or packages which may be totally lost in loading, transhipment or discharge, also for any loss of or damage to the interest insured which may reasonably be attributed to fire, collision or contact of the vessel and/or craft and/or conveyance with any external substance (ice included) other than water, or to discharge of cargo at port of distress, also to pay landing, warehousing, forwarding and special charges if incurred for which underwriters would be liable under a policy covering particular average. This clause shall operate during the whole period covered by the policy.

The American clause is essentially the same except that it substitutes the words "unless caused by stranding, sinking, burning or collision with another vessel" for the phrase "unless the vessel or craft be stranded, sunk or burnt."

Full Coverage Clauses. The following clauses indicate the breadth of coverage available for special classes of merchandise. The first of these is an "all-risks" form, with war risks, strikes, riot, and civil commotion excluded. This form is used in shipping adding machines, automobiles, motorcycles, and typewriters in cases. It provides as follows:

Against all risks of transportation and navigation, including theft, pilferage, non-delivery, and breakage, irrespective of percentage.

In the case of coffee from Brazil, one of the most frequent damages is the formation of moisture inside the ship, caused by the change in the temperature of the sea water outside the vessel. This is termed "sweat damage" and may run to large sums if the cargo is not properly protected. In addition to sweat damage, other water damage is covered, and losses are to be settled by skimming off the damaged coffee and paying for the depreciation, plus the cost of skimming and rebagging. This clause reads:

Subject to particular average irrespective of percentage, including damage by contact with fresh water and/or steam and/or sweat of steamer's hold. In case of damage by contact with sea water and/or fresh water and/or steam

and/or sweat of steamer's hold, the Company to pay on the damaged portions the cost of skimming and rebagging and the depreciation on the skimmings without reference to percentage, series, or insured value.

An example of coverage including a considerable element of land risk is found in the coverage for flour and mill products shipped to the United Kingdom and northern European ports. The policy undertakes:

To pay all claims for damage whatsoever to flour and mill products, arising from all hazards and dangers of transportation without regard to amount, from the time of leaving the mills in the interior of America by any conveyance by land or water until safely delivered at the port of destination, including risks of negligence excepted in bills of lading, including risks of transhipment from the vessel or quays to the customary point of delivery of the Steamship Line at the port of destination, including risks on quay and for seventy-two (72) hours after unloading at port or place of delivery before referred to, including risks of craft to and from the ship or vessel. The policy does not cover damage caused by weevils, insects, worms, grubs, or any inherent vice of the property.

The foregoing clause covering all risks on transportation hazards, but eliminating loss from "inherent vice" may be broadened by the inclusion of the "weevil clause," for an additional premium, to pay the cost of sifting any sacks of flour which on arrival prove to be weeviled, and to reimburse the insured for expense incurred in brushing or reconditioning such sacks, as well as for loss due to incidental consequential loss of weight.

Special Clauses for Merchandise Insurance. Frequently the bill of lading, which is in fact the contract between shipper and carrier, grants to the carrier certain liberties with respect to the voyage that ordinarily might unfavorably affect the rights of the insured under a marine policy. Likewise, bill of lading conditions exempt the carrier from liability for loss or damage caused by negligence of master or mariners, as well as from latent defects in the hull or machinery of the vessel. The policy may be written to give the insured permission to ship under such bills of lading.

The implied warranties concerning deviation and seaworthiness and all of the other implied warranties except that warranting the legal conduct of the voyage may be waived by agreement. Obviously, in most instances the insured has no control over the management or the condition of the vessel in which his goods are shipped, and insistence upon compliance with these warranties would tend to make the

insured uncertain as to the effectiveness of his coverage. In connection with the implied warranty of seaworthiness it is to be noticed that there is a warranty of seaworthiness of the vessel, but not of the cargo. Therefore, the shipper of a cargo may presume the vessel to be seaworthy and have no reason to believe otherwise. That his insurance may not be voided by a condition over which he has no control and of which he has no knowledge, he may have his policy endorsed, "Seaworthiness of the vessel as between the assured and the underwriter is hereby admitted."

In the case of deviation, the deviation clause provides that the policy shall not be voided by deviation of the vessel, change of voyage, overcarriage, or any error or unintentional omission in the description of interest, vessel, or voyage. The insured, however, must communicate the information of the deviation or defect to the company as soon as the information comes to him and, if required to do so, pay an additional premium.

Goods shipped to seaports where it is impossible for steamers to dock because of shallow water are unloaded by means of lighters or barges. In order to cover the goods during transportation by lighter or barge, the lighterage clause is attached to the policy. This reads: "This policy covers transit by craft and/or lighter to and from the vessel. Each craft and/or lighter is deemed a separate insurance." The reference to each craft as a separate insurance has the effect of applying any franchise in the policy to the value on the lighter. Hence, a 3 per cent franchise would mean a loss equal to 3 per cent of the value of the cargo before the insurers are liable for loss. The sinking of an entire lighter might not bring the claim to 3 per cent of the shipment. Under the lighterage clause, however, the franchise attaches to each lighter separately, so that a loss of 3 per cent of the value of the goods on any lighter, while so carried, warrants payment by the underwriters.

Assignment. Marine cargo insurance policies are commonly drawn in such a manner as to permit assignment before a loss and without the consent of the company. This is in direct contrast to the stipulation of the fire policy, which makes consent of the insurer a condition precedent to a valid assignment before a loss.

It is held that a marine policy is assignable at common law, but the validity of an assignment may be clouded with doubt when the interest of the assignee is such as to change materially the character of

the risk. In the case of hull policies, the question is definitely settled by incorporating in the policy a clause making the policy void if assigned without consent of the underwriter. In the case of cargo policies, the needs of modern business have created a demand for a readily assignable policy. To provide without question the right of assignment, policies are written "on account of whom it may concern."

Officers' Protective Policy. This policy is designed for officers of the merchant marine and covers the insured against loss or damage to personal effects, instruments, and equipment resulting from stranding, sinking, burning, or collision of a vessel. An extension of the coverage may be obtained to protect the insured officer against loss which he incurs when his license is suspended or revoked as the result of a marine casualty.

Cancellation and Premium Credits. When the marine underwriter assumes a risk, the premium is held to be earned. Hence, if a ship were lost because of some peril not covered by the insurance, the underwriter would be liable neither for the loss nor for a return premium. This rule holds for change of ownership as well.

As a matter of practice, however, the policy modifies this basic rule in the case of sale, and upon cancellation of the policy allows a return premium at an established rate per month. It is also customary to provide that in case of a lay-up for repairs, or because for any reason the vessel is out of service, there shall be a return premium for each fifteen or thirty consecutive days in port. A delay in port while the ship is in commission is not a lay-up warranting a return premium. To come within the meaning of the term, the owner must deliberately take the ship out of commission for a definite reason, such as lack of business, need for overhauling, or the like.

Winter-Mooring and Lay-up Clauses. Where navigation is seasonal, as in the case of the northern lakes, the vessel is of necessity in commission during only a part of the year. Policies are written, nevertheless, for the period of a year, since fire and other perils are matters of concern whether or not the ship is in commission. On the other hand, the underwriter is interested in the location and conditions surrounding the ship during the winter months and incorporates the winter-mooring clause in the policy making mandatory conditions satisfactory to the insurers. Likewise, in the case of lake policies, if the vessel be laid up in port during the season open for

navigation for a specified consecutive number of days, a return premium is allowed.

In the case of yachts operating on the Great Lakes or on the coasts within specified northern limits, such, for example, as the Eastport-Norfolk limits, it is customary to include in the policy the express warranty that they will be laid up and out of commission during the winter. The usual lay-up period extends from November 1 to March 1. Yachts whose cruising limits embrace only southern waters are insured with a full year's navigation privilege without the lay-up warranty. The same privilege may be given to yachts that are insured in northern waters but confine their cruising to southern waters during the winter.

Rates. Because of the very nature of the business, marine insurance lends itself less to the promulgation of established rates than do most of the other forms of insurance. Ocean marine insurance has long been written on the basis of judgment rates quoted by underwriters after an appraisal of the entire risk. In the field of ocean marine insurance, as in other fields, statistical data are, in fact, accumulated. However, because the hazards covered under a marine policy and the perils of each particular voyage tend to differ in so many respects, it is not easy to determine upon a rate that may be promulgated and generally applied. Even in the case of ships that are nearly identical in construction and following similar courses, differences in management, upkeep, and policies of operation could easily have the effect of requiring entirely different rates for the different risks. Again, ships sailing over an identical course present different risks in summer and winter. In some seasons cyclones may create a hazard, and in other areas there is a seasonal hazard created by icebergs. Entirely aside from the season, there are hazards to navigation that attach to particular voyages, such, for example, as fogs, shoals, inadequate aids to navigation, tides, and currents. In some areas inadequate anchorages create special hazards, as do unprotected harbors and dangerous approaches. Another important factor bearing on rates is the construction of the vessel. Vessel construction is a consideration, not only in the rate charged for the vessel itself, but as well in the rates for cargo transported in the vessel.

After all the physical factors applying to the ship itself and the condition of the voyage have been taken into consideration, weight is given to such factors as the nationality of the vessel, the reputation

of the owners, the conditions of the coverage, and the effect of trade customs. It is probably true that in no other branch of the insurance business is judgment so important a factor.

For convenience, marine insurance underwriters do promulgate advisory rates for certain types of shipments. Table 3 indicates the nature of such a rating classification. The rates quoted here are approximately the ones charged on a special risk or on a very small open policy. They are suggested for cargo shipments by owned, approved steamers of class A lines as per the company's steamer classification.

TABLE 3

CARGO RATES FOR MARINE RISKS* (RATES PER $100 INSURANCE)

	Via Atlantic Ports North of Hatteras	Via Atlantic Ports South of Hatteras	Via Gulf Ports	Via Pacific Ports Not North of Vancouver
Australia and New Zealand				
59. Via Cape of Good Hope	.75	.75	.75	..
60. Via Panama Canal	.65	.65	.65	..
61. By rail via Pacific ports	..	..	..	.45
Dutch East Indies				
62. Via Suez Canal	.60	.60	.60	..
63. Via Panama Canal	.65	.65	.65	.55
64. By rail via Pacific ports	..	..	..	.55
Hawaii				
65. Via Panama Canal	.40	.40	.40	..
66. By rail via Pacific ports	..	..	..	.25
Africa				
67. North Coast ports not East of Bone	.45	.45	.45	.75
68. West Coast ports	.55	.55	.55	.75
69. South African ports not East of Durban.	.40	.40	.40	.65
70. East Coast ports not beyond Mombassa	.55	.55	.55	1.00

United States Coastwise Shipments

	Via Atlantic Ports North of Hatteras
1. To U.S. Atlantic ports North of Cape Hatteras, and vice versa	.07½
2. To U.S. Atlantic ports South of Cape Hatteras, and vice versa	.10
3. To U.S. Gulf ports, and vice versa	.15

	Via Pacific Ports Not South of San Francisco
4. To Pacific ports North of San Francisco (but not North of Vancouver), and vice versa	.22½
5. To U.S. Pacific ports South of San Francisco, and vice versa	.15

* These rates are not definite quotations but are intended to serve only as a guide to agents.

TABLE 3—(*Continued*)

	Via Pacific Ports South of San Francisco
6. To Pacific ports North of San Francisco (but not North of Vancouver), and vice versa	.27½

	Via Atlantic or Gulf Ports
United States Intercoastal Shipments Via Panama Canal	
1. To U.S. Pacific ports not North of San Francisco, and vice versa	.27½
2. To Pacific ports North of San Francisco (but not North of Vancouver), and vice versa	.32½

	Via Atlantic Ports North of Hatteras	Via Atlantic Ports South of Hatteras	Via Gulf Ports	Via Pacific Ports Not North of Vancouver
Continent of Europe				
3. Holland, Belgium and France via ports between Bordeaux and Rotterdam, both inclusive	.15	.20	.22½	.50
4. France via French Mediterranean ports	.30	.35	.37½	.62½
5. Spain and Portugal via Atlantic ports in Spain and Portugal	.25	.30	.32½	.55
6. Spain via Spanish Mediterranean ports	.30	.35	.37½	.62½
7. Switzerland via ports between Bordeaux and Rotterdam, both inclusive	.20	.25	.27½	.60
8. Switzerland via French Mediterranean ports	.35	.40	.42½	.70
9. Italy via Italian ports not East of Sicily	.30	.35	.37½	.62½
10. Italy via Italian Adriatic ports	.45	.50	.52½	.87½
11. Hamburg and Bremen, Germany	.15	.20	.22½	.50
12. Interior of Germany via Bremen or Hamburg	.20	.25	.27½	.55
13. Denmark, Norway and Sweden not beyond Malmo	.25	.30	.32½	.62½
14. Sweden East of Malmo but not beyond Stockholm	.40	.45	.47½	.80
15. Poland, Danzig	.55	.60	.62½	.87½
16. Poland, Interior	.60	.65	.67½	1.00
17. Lithuanian, Latvian, and Esthonian ports	.60	.65	.67½	.87½
18. Lithuania, Latvia and Esthonia, interior	.70	.75	.77½	1.00
19. Finland, Helsingfors	.60	.65	.67½	.87½
20. Czecho-Slovakia via North Sea ports	.20	.25	.27½	.60
21. Austria and Hungary via Adriatic ports	.50	.55	.57½	1.00
22. Austria and Hungary via Hamburg or Bremen	.20	.25	.27½	.65
23. Jugo-Slavia (Serbia) and Albania ports	.45	.50	.52½	.87½
24. Jugo-Slavia and Albania, interior	.55	.60	.62½	1.00
25. Greece ports	.60	.65	.67½	.87½
26. Greece, interior	.65	.70	.72½	1.00
27. Black Sea ports	.60	.65	.67½	1.12½
28. Interior Roumania	.70	.75	.77½	1.22½
29. Interior Bulgaria	.70	.75	.77½	1.22½

This classification is generally used by marine insurance companies. It contains a list of class A steamship lines, the names of the owners and the names of the managing operators. A copy of the list is usually attached to each open cargo policy. These rates cover the shipment against perils of the sea while water-borne and as well (*a*) rail and local truck risk to or from interior places in the United States, (*b*) rail and local truck risk to or from the ports and interior places rated, (*c*) customary incidental lighterage to or from the steamer at the seaport.

In the case of a policy producing a sizable volume of business, the underwriter would probably be willing to quote a rate lower than those suggested in Table 3. Conversely, a policy on susceptible merchandise, regardless of the volume of premium, might require rates higher than those quoted. Again, the reputation of the shippers, their experience record, and the classification of the ship would operate to modify the suggested rates.

The Classification Societies. It has already been noted that vessel construction is an important factor in ocean marine rate making. Data bearing upon the construction and type of a vessel are assembled by classification societies and made available to insurance underwriters through periodic publications known as classification registers. Two of the most widely known of the classification registers are the "Record" of the American Bureau of Shipping and "Lloyd's Register of British and Foreign Shipping." From the registers are to be obtained the nationality of the vessel, the number of decks and their condition, the condition of the rigging, pertinent information touching upon the engine and boiler, as well as the equipment of the vessel, together with the port and date of last survey. The classifications regarding seaworthiness are based upon exhaustive data bearing upon construction, period of elapsed service, and other pertinent characteristics.

The work of the American Bureau of Shipping may be taken as an example of the usefulness of the classification societies to insurance underwriters. This society was organized as the American Ship Masters Association and incorporated April 22, 1862. The membership consists of about 120 persons prominently identified with the maritime commerce of the United States, including officers of the United States government.[3] The services of the bureau extend throughout the world. In addition to its own extensive staff it main-

[3] *American Bureau of Shipping, 75th Anniversary, 1862–1937* (New York, 1937), p. 38.

tains mutual agreements with contemporary societies, with the result that it is represented in every important port in the world. The bureau undertakes the following:

1. The publication in the Record of the American Bureau of Shipping of the essential particulars of the hulls and machinery of vessels classed with the Bureau, the classification assigned to each particular vessel, and the dates when the various surveys were made.

2. The issuance of certificates of character for merchant ships, their machinery and equipment, i.e., classification certificates, seaworthy certificates, etc., based on surveyors' reports.

3. The carrying out of load line surveys in accordance with the Department of Commerce Regulations, and the granting of load line certificates after the freeboard markings on the vessel's sides have been duly verified and found to be in accordance with the freeboard assigned.

4. The preparation of rules for the construction of hulls and machinery, including material specifications and detail regulations for periodical surveys, etc. These rules are modified from time to time in order to keep pace with developments in shipbuilding and marine engineering, and are the standards by which the eligibility of vessels submitted for classification is determined.

5. The carrying out, when specially requested by owners and builders, of such other work as relates to structural design, construction, and maintenance of merchant ships and also such important matters as relate to subdivision, etc.

6. The investigation by the technical staff of details in connection with the preparation of new rules and the analysis of the Surveyors' reports of surveys made on vessels in operation with a view to determining what amendments to the existing rules experience has shown to be desirable.[4]

The rules of classification societies are accepted as standards for the construction of ships and their machinery. Figure 2 on page 474 is a reproduction of a page from the Record of the American Bureau of Shipping and indicates the method of conveying all pertinent information concerning a ship through the use of abbreviations and symbols. Because of the international character of shipping and marine insurance, international agreements have been effected on fundamental principles governing safety regulations. These agreements provide for the mutual acceptance of technical standards, but the details of administration of the standards remain with the various societies.[5] The following excerpt from a publication of the Ameri-

[4] *Ibid.*, pp. 44–45.

[5] For example, the American Bureau of Shipping has entered into agreements with the British Corporation Register, the Registro Italiano, and the Imperial Japanese Marine Corporation whereby these societies represent the American Bureau in Great Britain, Italy, and Japan, respectively, and the American Bureau represents these societies in the United States.

1 No. Off. No. Sig. Ltr.	2 Name of Vessel / Former Name / Owner / Flag / Port of Registry	3 Type / Water Ballast: Spcs Tank Tons	4 Construction / Bulkheads: No. of Hatches, Largest Hatch; No. of Holds, Longest Hold	5 Fuel and Capacity / Appliances / Equipment	6 Dimensions Moulded / Registered: Lgth. Brth. Depth. / Deck Erections / Draft, Bale Cub. / Freeboard, Deadrise	7 Tonnage: Gross Net / Dead Wgt. / Displ.	8 Builders: Ship, Hull No. / Place, Date Built / Engine, Date Built / Boiler, Date Built	9 Type and Particulars of Machinery	10 Hull: Classification; Date of Last Survey; No., Port and Date of Last Periodical Survey / Machinery: Classification; Date of Last Survey Mchy. and Boilers; Date Tail-shaft Drawn; Etc. / Other Classification
3882 247,722 ANVS	**DENISON VICTORY**..... **War Shipping Administration** **Washington, D.C.** **(Interocean S.S.Corp., Operator)** **United States** **San Francisco, Cal.**	Sgl Sc AP 34 DTa 132' 1648 DB 306'6" 1524 FP 106	Steel; 3 Dks Metal Arc Welded (Gunwale Bar riveted) Trans Frmg 7 WT to Fbd Dk 2 WT to 3rd Dk 5 Ha 36'x22'4" 5 Ho 31'	Oil 2882 tons Rad Tel Rad DF Fath;GC Sub Sig C-39(S)	436'6" 62' 38' 439.1' 62.1' 34.5' F87' Dft 28'6½" 453M Fbd 9'7" Dr 0"	7607 4563 10681 15199	**Permanente Metals** 595 **Corp.** **Shipbuilding Div.Yd. No. 1** **Richmond, Cal.** 5-1945 **Westinghouse Electric** 5-1945 **Corp.** **Wickes Boiler Co.** 5-1945	**2 Cyl Stm Turb** SHP 6600;DR Gears 2 WTB;HS 12680;WP 525 Lbs FD;SH SBF;CL	✠A1Ⓔ 12-45 ✠AMS 9-45 EAC
3883 208,122 WDQD	**DENMARK**..... **Great Lakes S.S.Co., Inc.** **Cleveland, Ohio** **United States** **Oswego, N.Y.**	Sgl Sc Blk Car Mchy Aft DB	Steel; 1 Dk; Arch HB;Trans Frmg 3 WT 24 Ha;SC;12 Ft c-c 4 Ho 9'x36'	Coal Rad Phone Rad DF GC	448'9" 56' 28'1" 440' 56' 28' Great Lakes Dft 20'01" Fbd 8'2½"	5448 4434 —	**Toledo S.B.Co.** 114 **Toledo, Ohio** 5-1909 **Toledo S.B Co.** 1909 **Marine Boiler Wks.** 1909	**2 Cyl TE 23½" 36" 60"x42"** IHP 1540 2 SEB 14'6"x11'6";HS 5224 GS 120;WP 180 Lbs;ID	✠100 12-45 AS Toledo 12-45 Grain Carriage 3-45 Dkd12-45 BS 3-45 An MS 12-45
3884 207,182	**DENNIS T. SULLIVAN**.... **City of San Francisco,** **San Francisco, Cal.** **United States** **San Francisco, Cal.**	Sgl Sc Fireboat	Steel; 1 Dk	Oil	120' 26' 10.6'	244 140 — —	**Risdon Iron &** **Locomotive Wks.** **San Francisco, Cal.** 1909	**2 Cyl Comp 13" 20"x20"** IHP 1700 2 WTB; WP 200 Lbs	
3885 HPVV	**DENNY**..... **ex Tuxpam** **ex Honduras** **War Shipping Administration** **Washington, D.C.** **Panamanian** **Panama, R. P.**	Sgl Sc	Steel; 2 Dks 2 BH	Oil	235' 33'6" 21'3" 235' 33.6' 19.9' Dft 18'0½" Fbd 3'4½" 80M	1255 704 1700 —	**Fredrikstad** 195 **Mekaniske Vaerks.** **Fredrikstad, Nor.** 1915 **Fredrikstad** 1915 **Mekaniske Vaerks.** **Fredrikstad** 1915 **Mekaniske Verks.**	**2 Cyl TE 20½" 33" 56"x36"** IHP 900 2 SEB;HS 3943 WP 180 Lbs	Class Contemplated
3886 225,231 WNNP	**DEPENDABLE**..... **Mary Alioto** **San Diego, Cal.** **United States** **San Francisco, Cal.**	Sgl Sc MV	Wood; 1 Dk 2 BH 1 Ha 1 Ho	Oil Rad Tel	79.6' 23.3' 10.3'	163 91 — —	**J. M. Martinac** 85 **S.B.Corp.** **Tacoma, Wash.** 7-1936 **Washington Iron Wks.**	**Oil Eng** BHP 350	
3887 220,599 WDSB	**DERBLAY**..... **Alaska S.S.Co.**	Sgl Sc AP 91 DB 242' 658	Steel; 2 Dks Trans Frmg 2 WT to Fbd Dk	Oil 985 tons Rad Tel	320'3" 46' 26'6" 320.7' 46' 24.4' P28'3" Bpatos E33'	3475 2065 —	**Hanlon D.D.&** 85 **S.B.Co.** **Oakland, Cal.** 9-1920	**2 Cyl TE 24" 39" 65"x42"** IHP 1800 2 WTB;HS 7200;WP 200 Lbs	✠A1Ⓔ 9-45 2nd SS No. 2 Seattle 1-44

DER

The ✠ and Ⓒ prefixed to the Classification symbols denote vessels built under the supervision of the Bureau, the latter being applicable only to Great Lakes Vessels. The publication of the particulars of unclassed vessels is for general information only. While extreme care is used in the preparation of all information, the Bureau accepts no responsibility for any errors or omissions.

FIG.

can Bureau of Shipping points out the usefulness of classification societies to the business of insurance.

As an agency of the owners of merchandise and the ships in which this merchandise is to be transported, the underwriter is called upon to insure against the hazards of the ocean transportation to all ports of the world from points of origin to destination. When a commercial commitment is made and insurance requested of the underwriter, particulars of the specified vessel in which this merchandise is to be shipped, are not always known. In order that the underwriter may assume the insurance with a reasonable knowledge of the risk to be involved, he must be assured that the merchandise will be transported in a vessel of at least a certain standard. Therefore, it is necessary that the ships engaged in ocean transport be classified in accordance with certain standards affecting their seaworthiness which obviously involves exhaustive data in connection with their construction, period of elapsed service and general characteristics. The rules and surveys of classification societies not only supply standards, but make this indispensable data immediately available to the underwriter through periodical publication of registers containing information which aids the underwriter in appraising the insurance risk.

Thus, it will be seen, that the primary purpose of classification is to ensure the maintenance of seaworthiness of all classed vessels. Classification societies have sprung from many years of experience of marine underwriters in insuring vessels. This experience led underwriters to form what became known as the "list," and subsequently, the employment of a technical staff to examine vessels with a view to determining the nature of the risk thereon and to assist in defending claims involving technical questions. It followed in the course of time, that the ship-builder demanded some guide as to the constructional characteristics necessary to obtain the highest rating by insurance companies; hence, the necessity for the formulation of classification rules for the construction of vessels and for standards of maintenance. Since, in the last analysis, the owner's interest was a predominant one, the whole activity eventually became divorced from the underwriters, and classification societies were set up as separate, independent and unbiased technical organizations. In the American Bureau of Shipping all the interests, i.e., Governmental, ship owners, underwriters and shipbuilders, are adequately represented on the committees of management.[6]

FOR REVIEW

1. Is there a standard marine policy?
2. The owner of a cargo of goods expects to get a better price for them in the market to which they are being shipped. If he ships them in his own vessel and insures them, may he in the event of total loss collect the cost of the goods to him at the shipping point or the value of the goods at the point of destination?

[6] American Bureau of Shipping, *op. cit.*, pp. 35–36.

3. Some insurance policies describe the voyage as "from" and other as "at and from" a designated point. What is the difference in the coverages?
4. In the case of a voyage policy, what means are used to determine inception and termination of the coverage?
5. A cargo-laden ship arrived at her moorings and the same day was ordered to quarantine. Several days after, she was destroyed by fire. The cargo policy was written to terminate when "the ship hath moored anchor twenty-four hours in good safety." When did the policy terminate and was the loss covered?
6. A policy covered on the "Afton" for a voyage to any port of discharge in the United Kingdom and whilst in port during thirty days after arrival. Within thirty days after her arrival at Greenoch she started for Glasgow in tow. About 500 feet from Greenoch harbor she was capsized. Did the insurance cover?
7. With reference to time policies, when does the policy commence and when does it terminate?
8. A canal boat insured against the perils of navigation is separated from the tugs and driven ashore. As a consequence of weather conditions, after stranding, the boat is frozen in and cannot be moved. The policy provides that the cargo on the tug, if detained by ice or the closing of navigation, is no longer covered by the insurance. The property is destroyed as a result of the stranding, and the insurers deny liability because of the ice clause. What is your opinion as to the company's liability?
9. What type of vessel may be insured as a yacht?
10. Yacht and motorboat insurance is written both under a marine form and under a form covering the fire risk only. What additional protection is afforded under the marine form that the fire policy cannot give?
11. Explain the coverage afforded by the collision policy covering yacht.
12. Importers frequently purchase goods to be shipped them on a C.I.F. (cost, insurance, and freight) basis. By so doing, the goods which they import are insured for the account of the consignee by the shipper. Is such insurance adequate?
13. Does the term "ship" in a marine insurance policy refer to the hull or does it include fittings? If it includes fittings, enumerate what is included in the term over and above the bare hull.

Chapter XXIII

INLAND MARINE TRANSPORTATION POLICIES

INLAND Marine Defined. The uniform definition of marine insurance, it has already been noticed, includes the insurance of imports and exports in the ocean marine category. Inland marine insurance, on the other hand, includes within its scope (*a*) domestic shipments, (*b*) personal property floater risks, and (*c*) certain policies covering bridges, tunnels, and other instrumentalities of transportation and communication. Since the insurance of instrumentalities of transportation forms but a small part of the business of inland marine insurance, it may be stated that there are two major divisions, namely: (1) transportation insurance, and (2) personal property floaters.

Basically, to be eligible for an inland marine contract, the risk must involve an element of transportation. Policies are written on an all-risks basis subject to a limited number of exclusions indicated in the policy, or they may be written to insure only against specified hazards. Taking the ocean marine contract as the basic transportation policy, inland marine underwriters have incorporated features of the fire and casualty policies to meet the needs of adequate land transportation cover. As an outgrowth of the process of evolution, the inland marine contract now stands as a combination of marine, fire, and casualty policies.[1]

Transportation Policies. Transportation policies are designed to provide insurance for movable property while in transit. To effect this insurance, coverage is provided on the property while in the custody of a carrier. There are a number of available forms, each designed to meet a particular need. In addition to highly specialized forms, such as contracts designed to cover shipments by parcel post, registered mail, or money and securities in armored trucks, there are more or less standardized forms to cover goods, wares, and merchandise shipped in the ordinary course by common carrier. The policy designed to cover individual shipments is known as the "trip transit policy." Merchants, manufacturers, or others who ship and receive

[1] Appleman, E., *Inland Marine Insurance* (New York: McGraw-Hill Book Co., Inc., 1934), p. 13.

goods continuously may cover all shipments under a form known as the "transit floater." In the case of both the trip transit policy and the transit floater, the basic policy may be modified to fit the particular needs of the insured. The features of the basic contract, however, are generally to be found in all policies of a given class.

Benefit of Insurance Clause. In connection with bills of lading and the inland marine insurance policy there arises, as the result of clauses in each, a situation that apparently nullifies the insurance contract. Carriers have incorporated a clause in their bills of lading and receipts which provides that they shall have full benefit of any insurance that may have been effected so far as this shall not void the policies or contracts of insurance.

Marine insurance contemplates assumption of those hazards for which the carrier is not liable, and therefore when it insures against perils for which the insured has a claim against the carrier, it carefully guards its right of subrogation. To accomplish this, it incorporates a warranty in the policy, which states that the insurance is in no wise to insure directly or indirectly to the benefit of any carrier or bailee and declares the insurance void if any exemption from liability is given the carrier.

Obviously, if the insurance company pays the loss, the insurance is not void, but the insurer will have no right of subrogation. To get around the situation, underwriters pay the amount of the claim as a loan to the shipper. Since the loss is not paid to the shipper but only advanced as a loan, the carrier is not in a position to claim exemption. Since insurers have no guarantee in their insurance contract that this procedure will be followed and since, as a matter of fact, for such losses their contract is void, they feel that such claims are without legal basis and unenforceable. Whenever required by insureds, therefore, underwriters issue a separate letter, known as a "bailee letter," in which they assume the obligation of advancing the amount of the claim to the insured in the manner stated. This is designed to satisfy the insured and protect the insurer.

Single Shipments. Trip transit certificates are available for single shipments adapted to the needs of inland marine hazards. The policy is issued to cover shipments of approved merchandise, household furniture, livestock, and heavy machinery while in transit by freight, express, motor truck, and inland or coastwise steamers. The perils usually covered appear in the following clause:

Fire, lightning, cyclone, tornado, flood (meaning rising waters), earthquake, landslide, collision of the conveyance on which the goods are carried (coupling of cars not to be considered a collision), derailment, overturning of trucks, collapse of bridges or collapse and/or subsidence of docks, wharves, piers and/or bulkheads, landing sheds, depots, stations and/or platforms.

While water-borne, the goods are insured against stranding, sinking, burning, or collision of the vessel, including general average and salvage charges for which the insured is legally liable. Theft of entire packages may be included at increased rate under special conditions.

The policy provides that the company shall not be liable for loss or damage to goods caused by delay, wet, or dampness, or by being spotted, discolored, rotted, or changed in flavor; nor is it liable for leakage, breakage, marring, or scratching, except as the direct result of a peril against which the insurance is written. Unless provided by endorsement, the company is not liable for loss caused by theft, robbery, civil commotion, strikes, riots, war, and like hazards.

Endorsements in common use extend the coverage to indemnify the insured for loss by theft, riot, and civil commotion, and by fire while the goods insured are held temporarily in a warehouse for transshipment or packing. The theft endorsement provides cover for loss only if the entire package is stolen while in the custody of the carrier and expressly excludes the risk of pilferage. When express shipments by air service are insured, the policy is endorsed to exclude liability for loss to fragile or brittle goods unless resulting from fire or the accidental or forced landing of the airship. Valuable paintings and objects of art are shipped subject to the clause "warranted packed by expert packers."

Special Contracts. Contracts are from time to time issued covering on unique, unusual, or extremely rare properties that are in fact inland marine contracts, but because of the peculiar features of the risk often intrigue the public interests and are regarded as special forms of insurance. Insurance of $100,000 was placed on a copy of the Gutenberg Bible that covered while the book was on display at a luncheon in commemoration of the five-hundredth anniversary of printing. The Bible is owned by the General Theological Seminary and was taken from the seminary room where it is kept as a part of a rare collection and transferred in an armored truck under heavy police escort.[2] It was reported that a policy was issued by Lloyd's in

[2] *The Weekly Underwriter*, February 24, 1940.

an amount of £10,000[3] covering on a 1 cent stamp of an early British Guiana issue. The stamp at the time was part of a collection on its way to London to be sold at auction. The entire collection of which the stamp formed a part was said to have been insured for £30,000.[4] When the Dionne quintuplets were being filmed for their first feature-length picture, extreme care was taken of all the scenes as they were filmed. Any change in the appearance of one of the children might make the retaking of a scene impossible. As a matter of fact, it is reported that during the making of the picture two of the quintuplets cut teeth. Make-up men pointed out that in each case the new tooth radically altered the shape of the babies' mouths as they sometimes appeared in the photographs. Films, as they were taken, were carefully guarded in a steel-lined vault and were insured against earthquake, fire, theft, hurricane, scratches, or mishap of any sort that could prevent satisfactory development.[5] A policy was issued insuring thirty-two mules loaned by a state government to pull floats in a Mardi gras. The government loaned the animals only on the condition that insurance be provided to cover them adequately.[6] Another policy is reported covering four million cryptolaemus bugs for $20,000. The insects were imported to destroy the mealy-bug which in turn was destroying citrus fruit in this country.[7] The examples here cited are indicative of the extent to which marine insurance policies may be provided. A great many similar instances could be cited. Any legitimate situation involving transportation hazards is a logical occasion for the use of marine insurance. It does not follow that an underwriter may be found to insure every conceivable risk. So many strange and unusual risks have been insured, however, that it would be difficult indeed to indicate a line beyond which marine underwriters are unwilling to go. Although the business of inland marine insurance is picturesque and also so flexible as to extend to many unusual forms of cover, the great volume of the business is concerned with ordinary commercial ventures or personal property risks and is quite as prosaic as are the other forms of insurance cover.

Annual and Open Forms. To meet the needs of insureds who are constantly shipping or receiving goods, policies may be issued

[3] Equivalent to $48,000 at the then current exchange.
[4] *The Review*, March 8, 1935.
[5] *New York Times*, December 8, 1935.
[6] *Weekly Underwriter*, February 11, 1939.
[7] *The Review*, September 23, 1938.

to cover all their shipments, either incoming or outgoing, or both. There are two forms of policy in use. The coverage they afford is the same; the difference is in the manner of computing the premium. An annual form requires a deposit premium calculated at agreed rates and based on an estimated valuation of shipments to be covered during the policy period. At the end of the policy term an audit is made of the total value of all the shipments, and in accordance with whether the total value of all the shipments is under or over the estimate, an additional premium is charged or a return premium paid to the insured. The open policy requires no deposit premium, but instead, a monthly report with premiums due and payable when the report is made. A basic policy is used in writing transit insurance, but the coverage is described in a number of different riders, the one selected for use in a given case being chosen to meet the needs of the individual shipper.

The broad rail and water form covers the insured property at and in transit between specified points. It includes protection while the goods are in the custody of railroad and express companies, licensed public truckmen, inland and coastwise steamers, and barges, lighters, or other craft to and from these vessels. The coverage extends from the warehouse, store, or factory of the shipper, until delivered to the consignee, or until it arrives at the seaboard for export. Theft of the entire shipping packages is covered while the goods are in the custody of a carrier, and protection against pilferage and nondelivery may be obtained. The perils are otherwise much the same as those enumerated in the single-trip certificate.

In the more limited forms, the differences are to be found in certain exclusions. One form excludes water-borne shipments, except while on ferries and transfers, in connection with railroad shipments. Obviously, for many shippers, this form covers all their risk. Again, theft is excluded, while another form covers rail and water risks but only a limited number of perils. Another form is limited to covering goods while in the custody of public truckmen.

There are exclusions general in their nature that apply to all forms of transit policies. In the first place, it is provided that unless a particular agreement to the contrary is made a part of the policy, particular average losses under 3 per cent are not to be paid. Coverage on import shipments does not attach until the ocean marine policy has ceased to cover, and liability is excluded for loss of accounts, bills,

currency, deeds, evidences of debt, money, notes, and securities. The same exclusions appear as those found in the single-trip certificate relating to war, riot, delay, leakage, and the like. Riot and civil commotion coverage may be added by endorsement.

Express Shipments. When confined to express shipments the transit policy covers all risks of fire, lightning, cyclone, tornado, flood, earthquake, landslide, theft, pilferage, short delivery or nondelivery, transportation, and navigation. Aircraft shipments are not covered unless endorsed on the policy, and in that case a limit is set on each shipment with the usual restriction eliminating liability for fragile articles unless the loss or damage is caused by accidental or forced landing or by fire.

Because of the excess value charge made by the express company when the value of the shipment exceeds a designated limit, it is frequently found to be more economical for the shipper to insure under a transit policy which requires no declaration of value on the shipment. Incoming shipments may be insured under the same conditions, and when so insured, instructions are given shippers not to declare values on goods sent by express.

Department Store Transit. A special form of transit policy designed to meet the needs of department stores covers the goods of the insured against loss from all the perils enumerated in the broad form transit coverage while the goods are in transit by railroad, railway express, public truckmen, and coastwise steamship lines. Added to this coverage is an extension of the ordinary transit policy covering the merchandise while in the custody of messengers of the insured or while in transit in his own vehicles. Goods in transit for storage or repairs are likewise covered, whether or not carried and returned by the insured's carriers, as is loss from pilferage while in the hands of a common carrier. Exclusions are much the same as under the regular transport form, the main difference being the exclusion of loss of liquids by leakage unless caused by fire, collision, derailment, or stranding.

Owner's Goods on Owner's Trucks. For manufacturers, wholesalers, and other business establishments operating their own trucks for the transportation of raw material or finished products, or both, a motor truck merchandise floater furnishes protection against truck transportation perils. Few owners would consider putting a valuable truck into operation without adequate insurance. They sometimes

overlook the values loaded on the trucks, and in case of accident sustain severe losses. Not infrequently the value of the load is greater than the value of the conveying vehicle.

The owner's goods on owner's trucks coverage affords protection of the property of the insured, or goods in course of delivery but already sold, from the perils of fire, cyclone, and tornado, perils of the sea, rivers, and lakes while trucks are on ferries, also collision, overturning of truck, and the collapse of bridges.

Public licensed truckmen may not insure under this form, and goods of others carried for a compensation are excluded from the coverage, as are losses caused by riot, strike, and civil commotion. Losses due to breakage, leakage, and dampness are excluded unless caused by one of the perils against which the insurance is written. Insurance against theft of an entire shipping package or of an entire truckload may be endorsed on the policy by agreement and in consideration of an additional premium.

Truckmen's Legal Liability Interest. With the recent increases in volume of shipping by truck, legislatures have given consideration to the question of the ability of trucking concerns to settle claims for loss or damage for which they may become liable. The owners of the trucking business may not wish to insure against losses from this source, but as time goes on, statutory enactments are compelling public truckmen to provide themselves with a prescribed minimum coverage before a license is granted.

The legal liability of a truckman may be written under a blanket form or under a gross receipts form. Under the blanket form a list is made of the trucks operated by the insured and a limit of liability set for each truck. The premium is computed by applying the rate to the aggregate liability. Under the gross receipts form the rate is applied to the total receipts of the business. This form is considered to have an advantage, in that a percentage of every charge goes for insurance, and when the trucks are idle or empty no insurance costs accrue. Under the blanket form an estimated annual premium is paid, with the usual adjustment at the end of the policy term. Under the gross receipts form an advance premium is paid, and earned premiums are payable thereafter monthly on the basis of the monthly report. Both forms are subject to 100 per cent coinsurance.

Perils insured against are fire, perils of seas, lakes, and rivers, while on ferries, collision, overturning of truck, and collapse of bridges.

The policy assumes no liability for loss or damage caused by neglect to use reasonable means to save insured property at or after an accident, loss due to rough handling, damage to goods carried gratuitously or as an accommodation. The usual exclusions of losses due to riot, strikes, and the like are a part of the policy, as are the usual stipulations relating to wet, dampness, or spotting. Damage to the truck itself is not covered. In the case of breakage of eggs, damage must equal 50 per cent of the value of the package and be caused by the perils insured against before liability attaches to the insurer.

The risk of theft of an entire load may be covered, but companies are reluctant to accept the risk of theft of packages from a truck unless conditions are such as to afford a reasonable degree of protection. Theft of packages from open, unprotected trucks is ordinarily not written, and in any case, pilferage is not covered. When especially valuable shipments are forwarded in locked and guarded cars, the theft risk may be covered.

Parcel-Post Policy. One of the most widely used of all the inland marine coverages is the insurance of packages sent by parcel post. In spite of the care exercised by the government in handling the mails, it is to be recognized that post-office shipments are not immune to transportation hazards. The train carrying the mail may be wrecked, the post office burn, a ship meet with disaster, or other peril overtake the shipment. Merchants shipping a volume of goods each day recognize that at times there is an accumulation of considerable value at their risk in the local post office. The post office assumes no liability to indemnify the shipper for loss unless the parcel is insured by the government.

The insurance of parcel post by means of an insurance policy issued to the shipper appeals because of its convenience. Paper work is reduced to a minimum. Records are kept on the premises of the insured, and there is no necessity for delay at the post-office window every time a shipment is made.

Two forms of parcel-post policy are in use. The first of these is known as the "coupon form." Books are issued containing 100, 200, 500, and 1,000 certificates, together with a policy setting forth the terms of the insurance. Sometimes a policy is issued with each book, while other companies issue a master policy covering a period of a year, and books are issued as needed with reference to this master policy. In either case, coverage terminates at the end of a year, and

if the insured holds unused coupons, an extension of the policy must be granted by endorsement in order that their use may be continued.

Insurance of a package is effected by enclosing either in the package or with the invoice the number of coupons required and entering upon the stub provided for the purpose in the book: (1) the name and address put upon the package, (2) the description of the contents, (3) the valuation of the property, (4) the date of mailing, and (5) the class of mail by which sent. This completes the transaction, and no report to the postal authorities or to anyone outside the place of business is necessary. The package is deposited in the mails in the ordinary course. The following form is used:

No. 1—5022001

Name.....

Address.....

Class of Mail.....

Kind of Merchandise.....

Value $..... Date.....

In event of loss, this stub must be attached to Proof of Loss.

Certificate No. 1—5022001

THE SINGLETON INSURANCE COMPANY OF AMERICA

This memorandum certifies that in consideration of the premium and conditions named in the policy issued with the book from which this certificate is detached, the party named in said policy is insured as provided in said policy against loss or damage to the property contained in the package or described in the invoice with which this certificate is mailed.

The premium on this type of policy has varied, but the rate of 5 cents per coupon is generally required. The number of coupons to be used in each package depends upon the value and the class of mail used. With ordinary parcel post or unregistered mail, the requirements are:

Each package valued at $25 or less .....1 coupon
Each package valued over $25 and not exceeding $ 50 .....2 coupons
Each package valued over $50 and not exceeding $100 .....5 coupons

The limit of liability by unregistered mail or ordinary parcel post is $100, but if sent by registered mail or government-insured parcel post the limit is $500, with the following coupon requirements:

Each package valued at $50 or less .....1 coupon
Each package valued over $ 50 and not exceeding $150 .....2 coupons
Each package valued over $150 and not exceeding $250 .....5 coupons
Each package valued over $250 and not exceeding $500 .....8 coupons

When the insured parcel-post rate is used, the insured warrants that he will insure with the government packages valued under $100 for one-half their value, and packages valued over $100 for not less than $50.

The policy covers the property shipped against all risks, with certain exceptions, from the time its passes into the custody of the Post Office Department until it is delivered at the address of the consignee. Because of the nature of the exclusions, they are given herewith in detail as they appear in the policy. The statement is made that the policy does not insure:

Accounts, bills, currency, deeds, evidences of debt, money, notes or securities;

Merchandise shipped on consignment, memorandum or approval unless shipped in fulfillment of an order or request, or consigned to parties to whom the Assured has previously sold merchandise;

Merchandise such as green fruits, butter, eggs, lard or such other articles as are perishable in their own nature, except against the risks of fire, theft, pilferage and non-arrival only;

Loss or damage or the non-arrival of any package or any part of the contents thereof, which is incorrectly or insufficiently addressed; improperly or insecurely wrapped, packed or fastened; or on which the postage is not fully prepaid;

Shipments destined to transients at hotels unless sent by Registered Mail or Government-Insured Parcel Post;

Packages bearing descriptive labels or the outside of which tends to describe the nature of the contents;

Packages that do not bear a stipulation, "RETURN POSTAGE GUARANTEED";

War, Invasion, Hostilities, Rebellion, Insurrection, Confiscation by order of any Government, Public Authority, or risks of Contraband or Illegal Transportation and/or Trade.

With reference to the foregoing exclusion bearing upon descriptive labels, it is now provided in the policy that descriptive labels may be permitted on merchandise which by reason of the United States postal laws must be described on the outside of the parcel. Labels also may be used in shipping merchandise which, under the postal laws, may be sent at a reduced rate when the contents are indicated. This reduced rate regulation applies particularly to parcels marked "book" or "books."

The second form under which this coverage is written is an "open form," intended for large shippers. The coverage and exclusions are the same as under the coupon form. Under this form the policy limits may be increased by endorsement. The insured keeps a record

of all shipments, and the company is sent a monthly report, which serves as the basis for arriving at the premium.

Rates for the open form are fixed for each policy, based upon the type of goods to be insured, the volume of business, the limits for each package, experience where available, and any other pertinent information. As time goes on, the rate is adjusted upward or downward as experience warrants.

Since the rate is applied to the total monthly business, there is an economy in this form for the insured, not to be found in the coupon form. For example, under the coupon form it would cost one coupon to send a package valued at $25, but to send five packages each valued at $5.00 it would cost five coupons; yet the same value is at risk in both cases, and in the second case the upper limit for a single loss is $5.00. Under the open form all the values are added together and a rate applied to the aggregate.

A deposit premium is required amounting to the minimum annual premium. If premiums are paid monthly, the deposit premium may be waived, but the contract is in this case endorsed to indicate that it is subject to an annual minimum premium. It follows, therefore, that unless the shipper's volume is sufficient to warrant the payment of the minimum premium, the coupon form will best meet his requirements.

Money and Securities Coverage. Banks, trust companies, investment houses, and state treasuries have occasion constantly to ship bonds, securities, gold and silver coins, bullion, and valuable documents of every description to all parts of the world. Shipments of this character are covered under a registered mail policy designed for the purpose, covering shipments made by registered mail or express against all risks anywhere in the world. Risks of war and loss by theft committed by an employee of the insured, or by the persons to whom the property was entrusted for shipment, are the only exclusions. The insurance covers continuously from the premises of the sender until delivered to the addressee, or until returned for nondelivery. Both incoming and outgoing shipments may be insured.

There is no limit in the policy as to the amount that may be shipped; but, when shipments exceed a designated amount, the policy stipulates that notice must be given the company. It is customary to require this notice when shipments in a single day to one addressee are in excess of $5,000,000. Bank notes or legal tender notes are

limited to $250,000 in each package. No limit is made in the case of securities, except the notice if the daily aggregate to an addressee exceeds $5,000,000. The limit of liability assumed by the government on a registered mail shipment is $1,000, and on an insured parcel post shipment $200.

The insurance is written under three forms: (1) daily reporting, (2) monthly reporting, and (3) annual premium adjustment. In the first two cases, the premium is paid monthly; in the third, when the volume of shipments is not great, an advance estimated annual premium is paid, which is adjusted at the end of the policy term. In this last case the annual report is the only one required, except in the case of foreign shipments.

For those who ship money or securities only at infrequent intervals, trip certificates may be obtained to cover the risk.

In cases in which shipments are local, for convenience or because registry rates on high values make the method more economical, bankers have resorted to the use of armored cars and messengers for the transportation of money, securities, jewelry, and the like. To meet the need for coverage on this class of risk, the registered policy may be endorsed, or when required, a special policy is issued. In either case the coverage afforded armored car or messenger shipments is identical with that granted for registered mail shipments, though separate limits of liability are provided, depending upon whether shipments are made by armored car, messenger under armed guard, or messenger not under armed guard.

Bridges and Tunnels. Bridges, tunnels, and other instrumentalities of transportation and communication are insurable under an inland marine form provided the policy extends to cover risks in addition to fire, tornado, sprinkler leakage, hail, explosion, earthquake, and riot or civil commotion. These risks represent the hazards usually insured by fire companies. However, when in addition to the foregoing hazards the policies extend to cover such hazards as floods, rising waters, ice, collision, explosion, malicious damage, and collapse, the inland marine form is used. The policy in the usual course is not written to cover all risks, although in special situations insurance companies are willing to consider all risks forms or will cover specifically almost any conceivable hazard that may have the effect of damaging the subject of the insurance.

Bridges are owned not only by the various governmental units,

such as states and their political subdivisions, but also by carriers such as railroads, and not infrequently by companies who have built the bridges and operate them for profit from the tolls. Enormous sums are invested in a single structure, and sometimes the financing of the enterprise involves the floating of bonds and stocks. If the bridge represents the major asset of the company, the purchasers of securities are interested in the steps taken by the authorities to preserve the value of the assets. Likewise, state, county, and municipal authorities, as well as corporation directors, are impressed with the concentration of value in a single risk.

Bridge insurance covers direct loss or damage to the bridge and its approaches "however caused" with a limited number of exceptions presently to be noticed. The policy does not cover in the ordinary course losses caused by or resulting from strikes, lock-outs, labor disturbances, riots, civil commotions, sabotage, vandalism, malicious mischief, or the acts of any person or persons taking part in any such occurrence or disorder. The policy, however, may be extended at an additional premium to include these perils.

The usual policy does not cover loss arising from any act of government, from the violation of law, or from war risks. The coverage is terminated in the event of a suspension of use of the insured bridge through the operation of any ordinance or law, through injunction or court procedure, cancellation of license, or like cause. Losses occasioned by failure of the insured to maintain the structure properly are excluded, as are losses caused by neglect of the insured to use reasonable means to save and protect the property at or after any disaster covered by the policy.[8] Use and occupancy losses are not

[8] The George Washington Memorial Bridge spanning the Hudson River at New York City was at one time reported to be insured up to $25,000,000 against the perils of fire, explosion, lightning, collision, flood, rising water, floating ice, tornado, hurricane, cyclone, windstorm, waterspout, tidal wave, cloudburst, rainstorm, falling meteor, earthquake or other acts of God, malicious mischief, banditry, sabotage, anarchy, or other acts of violence, strikes, labor disturbances, riots or other civil commotion, collapse, failure, loss from seizure or detention, either on account of any illicit or prohibited trade or war. The cost of this bridge was $60,000,000, and it is operated as a toll bridge, yielding approximately $4,400,000 gross annual income. Obviously, its owners have endeavored to foresee every possible contingency that might occasion loss or damage to the property. Under the more recent direct damage "however caused" form it would be unnecessary to specifically list many of these perils.

It has long been recognized that bridges were susceptible to serious damage, but there has been a tendency to regard the possibility of total loss as remote. The collapse of the $6,400,000 Narrows Bridge over Puget Sound, November 7, 1940, four months after its completion, demonstrated beyond question the very real possibility of heavy

covered under the policy, but the coverage may be written covering against loss due to the total or partial suspension of use of the bridge necessitated because of a property loss or damage caused by peril insured against. The perils named are ordinarily the same as those recited in the property damage policy.

In both the use and occupancy and the direct property damage insurance, minor losses are excluded. In the use and occupancy policy a definite number of days is indicated, and no liability for loss arises unless the period of suspension exceeds the period indicated, and then only for the period in excess. In the case of direct damage, the coverage is subject to an agreed deduction, ordinarily not less than $1,000. Unlike the usual marine form, bridge policies are written with a coinsurance clause. The 80 per cent clause is customary.

A builder's risk form is available to cover structures under construction. The cover includes, in addition to the structure, materials at the site to be used in construction work during the period of actual construction and until the work is completed, accepted by the owners, or until the policy expires. Ordinarily, the policy is written calling for a monthly report showing total values at risk at the end of each monthly period. However, completed value forms, without the need for monthly reports, may be written for small projects. The policy, in contrast to the direct damage form written for completed structures, is written to cover against specifically named perils and these usually include: fire, lightning, flood, rising waters, ice, explosion, tornado, windstorm, earthquake, and collision. The collision coverage excludes loss or damage caused by collision with construction material or construction equipment. The same rules with reference to strikes, lock-outs, vandalism, and the like apply in the case of builder's risks as applies in the direct damage policy; that is, these risks may be endorsed on the policy for the payment of an additional premium, but they are not otherwise included.

Insurance on tunnels and other instrumentalities of transportation and communication is written to cover essentially the same risks as those provided for bridges, and the policy forms are similar.

losses. The center span swayed and buckled in a high wind. Two main towers were left standing, although these were reported to be seriously damaged. The bridge was insured under an all-risks inland marine form and the cover, it is reported, was divided among twenty-two companies. The property damage cover was $5,200,000 and the loss determined to be $4,000,000. The insurers agreed to pay the Washington State Toll Bridge Authority this amount in cash, the state to retain all salvage and to retain interest in the portions of the bridge still standing, such as piers and anchorages.

War Risk. As was the case with ocean marine insurance, the advent of World War II focused the attention of inland marine underwriters upon war risk hazards. Some inland marine policies already contained exclusions as to war risk, but in others, no such exclusion appeared in the policy. Effective March 1, 1940, the Inland Marine Underwriters Association adopted the following clause as the approved association war exclusion clause:

> This policy does not insure against loss or damage arising from War, Invasion, Hostilities, Rebellion, Insurrection, Seizure or Destruction under quarantine or Customs regulations, Confiscation by order of any Government or Public Authority, or risks of Contraband or Illegal Transportation and/or Trade.

The association requires this clause to appear in all policies of the following listed classes: (*a*) fine arts (commercial and public risks), (*b*) transportation, (*c*) motor truck cargo (shippers' and carriers' interest), (*d*) bailee's customers, (*e*) bailee's liability, (*f*) processing risks, (*g*) deferred payment merchandise, (*h*) woolgrowers, (*i*) garment contractor's floater. In the case of policies in force without the clause, it was permitted that they run to expiration, but the clause was made mandatory on new policies written after March 1, 1940.

In order to establish a uniform practice in granting war risk insurance under all classes under the jurisdiction of the association, it was provided that all war risk insurance be the subject of special acceptance in accordance with the following endorsement:

> This policy is extended to cover against the risks of War, Invasion, Civil War, Hostilities, Rebellion and Insurrection and Civil Strife arising therefrom, including the risks of Aerial Bombardment, subject to the following limitations and conditions:
>
> 1. This endorsement does not cover any loss or damage caused by or resulting from any of the following:
>   *a*) Seizure, detention or confiscation under customs or quarantine regulations;
>   *b*) Commandeering, preemption, requisition or nationalization by any government, *de facto* or otherwise;
>   *c*) Seizure, detention or confiscation by the Government of the United States or Canada based on enemy ownership or interest, or on violation of law;
>   *d*) Delay, deterioration and/or loss of market.
> 2. This endorsement shall not cover outside of the Continental limits of the United States and Canada.
> 3. This endorsement shall not cover shipments destined for export by over-

seas vessels, nor imports after discharge from overseas vessel while in transit to destination.

4. This endorsement may be cancelled by either party on giving five days' notice in writing.

The rules permitted members of the association to substitute the free of capture and seizure clause of the American Institute of Marine Underwriters in lieu of the exclusion just cited. War risk insurance may also be provided for coastwise vessels on a declared risk basis with individual or monthly reports and overseas vessels on a declared trip basis.

FOR REVIEW

1. Recent floods in this country have brought forcibly before property owners the danger of damage to property by flood and rising waters. What form of flood insurance may be obtained?
2. A carload of flour shipped from Minnesota to Frankfort, Kentucky, was destroyed in the 1937 flood. Is this covered under a marine policy?
3. X, a truckman, carries the truckmen's legal liability coverage in the amount of $5,000. While carrying a shipment of oriental rugs valued at $15,000, his truck overturns and catches fire. He is able to save part of the shipment, and the actual loss is $4,000. What is the collectible amount of insurance?
4. B, a truckman, agrees to move a piano for a friend without charge. Owing to the collapse of a bridge, the piano is destroyed. Is the risk covered by the truckmen's legal liability policy?
5. X sends a shipment of eggs insured under a parcel post policy. To what extent does the policy cover?
6. X is a guest at the Blank Hotel. A suit of clothes is sent him from a merchant in a neighboring city. What steps should the shipper take to make his parcel post insurance effective?
7. B is branch manager of a large brokerage house. Late in the afternoon he receives a shipment of $50,000 in negotiable securities. It is too late to place these securities in the vault of a bank, and the safe in the local office is not designed to protect such values. Advise the manager of the branch how, through the agency of insurance, he may adequately protect these securities until morning at comparatively small expense.
8. You have been asked to examine the insurance policies of a shoe manufacturer. You find that from time to time he has large values in leather in the hands of tanners. He carries fire insurance on this material up to 100 per cent value with a 90 per cent coinsurance clause. What marine coverage furnishes adequate protection, and to what extent is the coverage broader than the fire policy?
9. X, a mortician, is preparing a body for shipment to China for burial. While the body is in X's charge, a fire originating on his premises destroys it. Because of the religious belief of the deceased, the place of burial of

the body is important. Relatives bring suit against the mortician. Is he liable for damages, and is the risk insurable?

10. When does the liability of the carrier commence?
11. X ships a package weighing fifteen pounds valued at $200, receiving a receipt limiting the liability of the express company to $50. Upon receipt of the package, the consignee notices it to be damaged. May he refuse to accept it on the grounds that it is insured and make a claim against his insurance company for the full value of the package? In the above case, what is the liability of the express company?
12. A shipper sends by express five oriental rugs each valued at $300 and declares a value of $300. The total value of the shipment is $1,500 and is insured for that amount under a trip transit policy. In the event that one rug is lost, is the carrier liable for one-fifth of the loss or for the total amount?
13. Explain the dual capacity of a common carrier regarding liability for safe delivery of merchandise accepted for shipment.
14. If a consignee fails to call for goods within forty-eight hours after notice of arrival is sent or given, what is the liability of the carrier, and how may transit insurance benefit the consignee?

Chapter XXIV

INLAND MARINE INSURANCE

Personal Property Insurance. The final section of the subdivision of the Nationwide Definition and Interpretation of the National Convention of Insurance Commissioners which defines inland marine coverages, deals with personal property floater risks. The coverage divides into two groups. The first covers individuals, when there is no commercial or business element involved. The second group includes floaters when the commercial element, as in the first group, may be entirely lacking, or when the use of the insured goods is primarily or entirely for business purposes and when the ownership is either an individual proprietorship or any of the other usual forms of business organization.

Personal Effects Floaters. One of the most important and widely used coverages is found in the protection of personal effects. The policy covers such personal effects as are usually carried by travelers, belonging to and used or worn by the insured, his wife, and their unmarried children permanently residing together. For an additional premium the policy may be endorsed to cover additional named insureds residing permanently with the insured named in the policy.

The coverage is world-wide and automatically attaches whenever the property may be outside the insured's permanent residence, garage, or place of storage and thus placed outside the protection of insurance covering at these locations. The coverage, therefore, has a wider use than the protection of baggage during travel, as it covers clothing at a laundry or at the tailor's; personal effects at school, in automobiles,[1] trains, streetcars, buses, stores, theaters, hotels, restau-

[1] It is the purpose of the personal effects policy to furnish a broad and comprehensive coverage. Losses by theft of personal effects such as coats, furs, packages, bags, and the like left in unlocked and unattended automobiles have given rise to considerable annoyance to insurance underwriters, because in most cases such losses are the outgrowth of a careless disregard for the safety of the property insured. After March 1, 1936, the coverage for losses caused by theft of personal effects from automobiles was limited by an exception incorporated in the policy in the following terms:

"Except when in the custody of a common carrier; loss or damage caused by theft or pilferage of the insured property while left unattended in or on any automobile unless such automobile is equipped with a fully enclosed body or compartment, and the loss be a direct result of violent forcible entry (of which there shall be visible evidence) from a fully enclosed body, the doors and windows of which shall have been securely

rants; in fact, anywhere outside the domicile of the insured with certain exceptions. To cover in dormitories, fraternity houses, or on the premises of schools or colleges, the policy must be specially endorsed, and an additional premium paid. If there is no state law to the contrary, the policy may be endorsed to cover at the domicile of the insured.

Property specifically excluded from coverage includes automobiles, motorcycles, bicycles, boats, motors or other conveyances or their appurtenances, accounts, bills, currency, deeds, evidences of debt, letters of credit, passports, documents, money, notes, securities, railroad or other tickets, household furniture, animals, artificial teeth or limbs, automobile robes or other automobile equipment, salesmen's samples, merchandise for sale or exhibition, theatrical property of any kind, and any property specifically or otherwise insured. The policy does not cover jewelry, watches, and furs for more than 10 per cent of the total amount of insurance for which the policy is written, or for more than $100 on any one such article.

Other exclusions under the policy include loss or damage caused by gradual deterioration, moth, vermin, inherent vice or damage sustained due to any process or while being actually worked upon and resulting therefrom, as well as loss or damage arising from war, invasion, hostilities, rebellion, insurrection, confiscation, and like perils. Breakage of articles of a brittle nature is not covered unless caused by thieves, fire, or accident to conveyances.

Personal Property Floater. This policy, usually known in order to distinguish it from the personal effects floater as the "householder's comprehensive policy," is coming into greater and greater acceptance as the broadest possible coverage obtainable on all personal property. The personal property floater provides all the protection obtainable under the personal effects policy and as well includes all of the personal property of the insured not otherwise covered by insurance, whether located in the permanent residence of the insured or elsewhere. The policy covers all risks and is world-wide. It therefore provides in one contract insurance against such perils as fire, wind-

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locked, or from a compartment which shall have been securely locked, but in no event shall this company be liable under this clause for more than 10% of the total amount of insurance for which this policy is written, nor for more than $250 in any one loss."

The clause may be eliminated from the policy when, in special circumstances, the insurance company is willing to assume the risk, upon payment of an additional premium.

storm, hail, explosion, water, earthquake, burglary, theft, and such other perils as might in the ordinary course of business be covered under specific policies.

Insureds not acquainted with the technical phases of the insurance business do not always know of the existence of this contract. The growing trend in the insurance business toward comprehensive policies is definitely the outgrowth of customer demand. This demand is unquestionably evident in the field of fire insurance. In an effort to provide a more comprehensive cover, the extended cover endorsement was made available. Insureds have been asking for more complete protection. It is their wish that their property be protected from all perils rather than from a selected few. To this demand the householder's comprehensive policy is the answer.

Since the policy covers property located in the permanent residence of the insured, it is not, in the strictest sense, a marine contract. The uniform definition of marine insurance excludes the cover, but in a number of states administrative authorities early made an exception permitting it. The popular appeal of the insurance and the demand for the cover tended to overcome the technical situation created by the uniform definition, and within recent years the policy has been authorized in every state in the Union.[2]

The policy is written in three sections: (*a*) a blanket section covering unscheduled personal property, (*b*) schedule section covering specific items of personal jewelry, watches, furs, fine arts, and other similar properties, and (*c*) blanket coverage on jewelry, watches, furs and the like.

Because of the broad coverage afforded, the policy is beginning to occupy an important position in the property insurance field with major emphasis upon the coverage in the fixed location of the home. Though still listed as a marine coverage, the marine aspects of the policy are tending to become more and more incidental. For the home owner with valuable furnishings and personal effects the policy offers an extraordinary all-risks coverage. The policy has become an important coverage for fixed property.

Furs and Jewelry. Individual fur pieces, or fur coats which belong to the insured or to members of his family residing permanently with him, are insured under a world-wide fur floater policy covering

[2] Maine, the last state to make an exception to the uniform definition, authorized the form in 1946.

the property wherever it may be, in the home or elsewhere. The policy covers against all risks. The only exclusions are gradual wear and tear, moth, vermin, inherent vice, or damage due to any process or while being actually worked upon and resulting therefrom, war risks and loss due to government order, illegal transportation or trade.

Each piece of fur insured must be specifically scheduled in the policy and carefully valued. When new, the cost price is acceptable as a valuation; otherwise, an appraisal by a reliable furrier is preferable, unless the insured is willing that a valuation be fixed as between himself and company, taking into consideration age and depreciation. It is an underwriting practice not to insure furs for an amount greater than their cost, regardless of what an appraisal will show or through what agency the insured was able to secure a price less than the current market value.

When both furs and jewelry are to be insured, they may be covered under a single policy, and silverware and plateware may be included if desired. An advantage is found in including all items in a single policy because, as aggregate values exceed designated limits, the rate on the excess drops. A further reduction in the premium may be obtained if a $50 deductible clause is made a part of the policy.

Because of the element of moral hazard, the insurance of furs and jewels is most carefully underwritten. Persons known to be careless are never acceptable as insureds, nor are those living in sections where there have been frequent burglaries. The integrity of the insured must be unquestioned. In every case involving the insurance of jewelry or expensive furs, confidential report is made on the insured by sources entirely independent of the agent placing the business.

Salesmen's Floater Policies. Substantial sums of money are invested in samples to be transported from place to place for display to prospective customers. There are as many classes of samples as there are types of business. Obviously, a case of shoe samples, with only one shoe of a kind, is less of an attraction to thieves than is a case of jewelry. Some samples are shipped by railroad or other transportation company, while others are transported in the automobile of the salesman. Again, extremely valuable items are carried in cases constantly in the care of the salesman or in charge of another responsible custodian. Salesmen's floater policies are written under one of three general forms, though any form may be modified within limits to

meet a particular need. The forms are referred to as "limited," "broad," and "all-risks."

The limited form covers the samples, and the trunks and containers in which they are transported, against the perils of fire, lightning, explosion, cyclone, tornado, flood, and the perils of navigation and transportation, as well as theft of an entire trunk or shipping package in the custody of any common carrier, or while checked against receipt with any hotel or public checking room. Losses caused by riot, civil commotion, and strike are excluded. Losses by pilferage are not covered, nor are theft losses of jewelry or like valuables, or losses by theft while the property is in the custody of the insured or their salesman. Losses by leakage, breakage, and scratching are covered only when caused by a peril insured against; nor is there any liability because of delay, improper packing, or inherent defect in the property.

The broad form covers all risks, subject to limitations to be noted. Unrestricted theft coverage is provided except in the case of theft from automobiles left unattended. In the case of approved commodities, the policy may be extended to cover pilferage under the same conditions that theft is covered under the limited form.

The all-risks form includes theft from unattended automobiles subject to the locked-car and forcible entry warranty. Under this coverage the insured warrants that all the automobiles in which the insured property is carried are equipped with closed bodies and suitable locks. The company usually approves the type of lock before it will issue the policy. Loss from such cars is covered only if there is visible evidence of a forcible break, or if the entire automobile is stolen or driven away.

The exclusions under the broad and all-risks forms are substantially the same as for the limited form, except that there is no theft exclusion. It is provided that the policy does not cover the infidelity of the employees of the insured or persons to whom the insured property is entrusted. When the locked car and forcible entry warranty is used it does not cover theft of property from cars in garages overnight. All policies exclude coverage on the premises of the insured.

Horse and Wagon Floater. Coverage may be provided under a special form for specified amounts on horses, mules, wagons, and equipment, against fire, lightning, and the usual perils of transportation. Rates for this coverage are based upon the fire tariff rate of the

highest rated premises where the insured property is usually kept. Collision coverage is available upon payment of an additional premium, as are theft, riot, strikes, tornado, and windstorm coverages.

Policies are issued both on horses and on equipment used for commercial deliveries, as well as on saddle horses, jumpers, and other noncommercial animals or equipment. In the case of racing stables the horses and equipment are insurable under the form, though it does not extend to afford adequate coverage when a particular horse has acquired a high value through racing performance. The policy is found particularly adaptable to the needs of dairies, breweries, department stores, and others who find the horse and wagon method of delivery best to meet their needs.

Theatrical Floater Policy. The producing of plays is a type of business involving substantial sums of money invested in scenery, costumes, and other theatrical properties that are continually transferred from place to place while the production is on the road. The theatrical floater policy covers goods of this description while in theaters and other business buildings, except the customary business premises of the insured, against loss or damage by fire and lightning and against the risks of fire, lightning, collision, overturn, or derailment while in transit.

The policy exempts from coverage loss from riots, strikes, and the like; loss from a falling building, explosion, or neglect of the insured to use reasonable means to save the property at or after an accident. Theft is not covered, nor is loss of money, notes, securities, and the like. Livestock is insured against loss by fire only.

Installation Risks. There are a number of concerns whose business is of a nature that requires the complete installation of their product in working or serviceable order in the premises of the customer before delivery is completed. For example, houses specializing in store fixtures contract to remodel a given location from a new front to interior decoration. Again, pipe organs sold to churches, public buildings, and residences are delivered installed, as are heavy machines, carillons, and the like. A given business at any time will have goods in numerous locations and in transit, and installation in all degrees of completion.

Such risks may be insured covering the goods against fire and transportation perils, and perils on the premises to which they have been consigned until installation is complete. A deposit premium

is paid and monthly reports are required indicating the average daily values upon which the insurance has covered.

Processor's Risks. Certain steps in turning out manufactured goods are often entrusted to concerns that specialize in a particular process. An example is to found in the tanning of hides or the dyeing of cloth. The manufacturer finds that the work can be done more expertly and at less cost outside the plant, and consequently has from time to time large values at risk, either in the hands of the processor, or in transportation to and from his plant.

A special transit policy covers merchandise, not only while in transit to and from the processor, but also while held by the processor if the owner of the goods has neither ownership nor control of the processing plant. The policy is written with an estimate of the full value of goods to be shipped to processors during the policy year, and a deposit premium is paid on the estimated amount. The company requires monthly reports of the names and locations of all processors to whom goods have been sent during the preceding month. At the end of the policy period a premium adjustment is made, based upon the record of actual shipments.

Conditional Sales and Merchandise on Approval. Floater policies may be written covering department stores and other business houses against loss of goods sold on the installment plan, loaned, leased, or sent on approval. The development of merchandising during the past decade has made it a usual practice to send out to prospective customers on approval or for trial such commodities as rugs, radios, refrigerators, furniture, washing machines, and the like. Sales frequently involve installment payments. The policy covers the goods while in transit against the perils of fire, collision, cyclone, flood, theft, sprinkler leakage, and breakage when the damage exceeds a specified minimum. It covers in buildings, excluding premises owned, rented, leased, or used for storage or exhibition purposes by the insured, against fire, lightning, and any of the aforementioned perils required by the insured. Exclusions are wear and tear, wrongful conversion by persons to whom the insured property has been entrusted, and war risks. When there is other insurance, the floater does not contribute, but applies as excess coverage after the specific insurance has been exhausted.

The policy is written on an open form and may cover the interest of the dealer only or cover the interests of both dealer and purchaser.

In the case of loss under the first plan, the liability of the insurer is limited to the unpaid balance at the time of the loss. In cases in which both interests are covered, however, the dealer receives the amount of the unpaid balance, and the purchaser the amount paid by him as installments up to the time of the loss.

When both interests are covered under the policy, a certificate form is available under which the dealer may issue a certificate to the purchaser to hold as evidence of the insurance. This form is particularly desirable when the purchaser pays for the insurance in the sales agreement. Copies of the certificates as issued are mailed to the company, and the premium is payable at the end of each month for the business reported during the preceding month.

When certificates are not required under either plan, a monthly reporting form is used. At the end of each month a report is made of the total values at risk under partial payment sales, plus full value of all merchandise loaned, leased, or sent out on approval.

It sometimes happens that under the terms of the sales agreement the purchaser is obligated to keep the goods insured, covering the interest of the seller as well as his own. The purchaser may inadvertently allow the policy to lapse, or for some other reason the protection may be inadequate. In case the property in question is destroyed and no insurance is forthcoming, the purchaser is obligated to continue the payments, which he is frequently unable to do. For such situations the dealer may purchase a contingent form at greatly reduced rates. Under this form the insurer is obligated to pay only so much of the amount due the dealer as proves, after reasonable effort, to be uncollectible. In no case is the purchaser freed from his obligation. The insurance company takes the rights of the seller by subrogation to the extent of its payment.

Furriers' Customers Insurance. Furriers and department stores accepting furs for storage offer as part of their service insurance protection on the stored items. The policy is written on a special inland marine form, and insurance certificates are furnished the dealer to issue to customers. The dealer is named in the policy as the insured, and all furs or garments for which certificates have been issued are covered. The coverage is for all risks and subject to the same limitations as the personal fur floater. The certificates are written for a term of one year. Daily reports of new risks are required under this form, and no insurance attaches until the certificate is issued. Rates

for this class of business depend upon the construction of the vault used by the insured for storing the furs, its location, burglary protection, valuation of the items, and amount at risk. The premium is paid by the dealer, and no premium charge is made directly to the owner of the garment insured, this being included in the general charge for service.

In some cases customers do not wish coverage for the period of a year, and for them a short-term form is available. The coverage may be limited to such perils as the dealer desires to insure against, and these are confined to the period during which the garments are in his custody, plus the transportation risk to and from the insured's place of business. Under this form monthly reports only are required.

The furriers' customers policy may be written to cover specifically the legal liability of the furrier without regard to the insurance that may be carried by the customer. It is of the utmost importance that a furrier place no reliance upon the insurance of customers unless the policy is written to include the furrier as well as the customer. It is quite possible that an insurance company would pay the insured owner for furs lost while in the custody of a furrier, and then under its right of subrogation hold the furrier responsible to the extent that liability could be established. It is to cover this hazard that legal liability is available.

Jeweler's Block Policy. This policy incorporates in a single contract the different insurance coverages usually required by jewelers. The policy covers pearls, precious and semiprecious stones, jewels, watches and watch movements, gold, silver, platinum, other precious metals, and other stock usual to the business of a jeweler. The coverage applies not only to property owned by the insured, but also to property as described in the policy delivered or entrusted to the insured. In the latter instance, when the property delivered or entrusted to the insured belongs to dealers or others engaged in the jewelry business, the coverage is limited to the extent of the insured's interest, because of money actually advanced thereon, or because the insured is legally liable for loss or damage thereto. When claim originates because of legal liability, the policy covers whether the liability originates from negligence or from contract.

The policy is an all-risks contract subject to certain exclusions, the most important of which have to do with the dishonesty of the insured or his employees, or with losses occasioned by working on the prop-

erty, or by war, strikes and riots, storms on land, or unexplained shortage. There is no liability on the part of the insurer for loss or damage to goods while they are being worn, while on exhibition or in a vehicle unless attended by the insured or some person whose duty it is to attend the vehicle. Shipments are covered only if the packages are sent sealed by railway express or by registered mail. The goods, with the exceptions noted, are covered wherever they may be within the territorial limits described in the policy against loss or damage "arising from any cause whatsoever." The coverage is very broad.

Scheduled Property Floaters. To effect insurance on property when specific policies have not been sufficiently comprehensive to provide adequate coverage, the scheduled property floater provides broad and adequate protection. Almost any type of floating property may be covered under the form, though for certain classes, such as musical instruments and objects of art, a special policy is used. The coverage may be for all risks or may be limited to designated perils, depending upon the nature of the property and the needs of the insured. The usual exclusions are wear and tear, gradual depreciation, infidelity, and war risks.

To be covered under this policy, the property must be carefully scheduled. It must be described in sufficient detail as to indicate clearly the item to be covered, and, when more than one item is covered, each must be separately valued. Some of the more usual classes of property for which special riders are available and for which the coverage is more or less standardized, include the following:

a) *Military and Naval Effects Floater.*—Under this form the personnel of the army, navy, marine corps, and diplomatic corps may secure broad protection for their personal property. Personal effects of all kinds are covered, including household furniture and military and naval equipment of every description, belonging to the insured and dependent members of his family. The policy covers all risks of fire, lightning, navigation, transportation, theft, pilferage, and larceny in the continental United States and its insular possessions, the Panama Canal Zone, the Dominion of Canada, British North America possessions, and Haiti. When required, the coverage can be extended. The theft, pilferage, and larceny coverage in the case of furs, jewelry, watches, and other like items is limited to 40 per cent of the policy amount. Theft of coats, hats, caps, and the like from an automobile is excluded.

b) Cameras, Projection Machines, and Equipment Floater.—This form provides an all-risks coverage on cameras, projection machines, and equipment for both professionals and amateurs. The usual exclusions apply, plus loss caused by aerial flight. This last exclusion may be eliminated upon payment of an additional premium.

c) Contractor's Equipment Floater.—This policy covers the floating property of a contractor, such as steam shovels, cranes, derricks, hoisting machines, compressors, power drills, stone crushers, concrete mixers, engines, boilers, pile drivers, tractors, wagons, chains, ladders, scaffolding, hand tools, and other like equipment. A complete schedule of each item is required except that hand tools and small items may be grouped. The perils insured against vary, but may include fire, explosion, flood, cyclone, earthquake, collapse of bridges, theft, collision, including upset or overturning of steam shovels and like equipment. In addition to the usual exclusions, the policy does not cover loss from excessive loading, loss to automobiles, underground property, or electrical damage to dynamos and the like.

d) Outboard Motors and Motorboats Floater.—This policy covers both the boat and the motor. The boat is covered against direct loss or damage caused by fire, theft of the entire boat, or loss or damage caused by collision with another vessel. The motor is covered separately whether on board any boat, attached to any boat, or while ashore, against transportation perils, theft of the entire motor, fire, collision, and marine perils, including loss overboard. In addition to the usual exclusions, the policy is void if the boat is rented, used to carry passengers for hire, used in illicit trade or in any official race or speed test.

e) Physicians' and Surgeons' Instruments Floater.—Under this policy instruments and apparatus used in their profession by physicians, surgeons, and dentists are covered against all risks except breakage of glass and brittle articles, unless the breakage is caused by fire or thieves. The coverage extends to include operating tables, X-ray equipment, violet ray lamps, and other like equipment, but not office furniture, books, or furnishings. The policy is written in three forms: (1) specific, (2) semiblanket, and (3) blanket. Under the first form, each article is scheduled and valued; under the second form, instruments and apparatus are grouped separately and written with 100 per cent coinsurance; under the third form, instruments and apparatus are covered in a lump sum with 100 per cent coinsurance

as before. The rates are lowest on the specific form and are highest on the blanket.

f) Silverware Floater.—Silverware, silverplate, and pewterware can be insured against all risks under this policy. In addition to the usual exclusions, the policy does not cover claims arising from denting unless caused by fire, tornado, burglary, or theft, or loss occasioned by breakage of glass or brittle parts. Flasks, smoking implements, pens, and pencils are ordinarily not covered. When loss or damage occurs to any item that forms one of a pair or set, the company assumes liability only for the parts actually lost or damaged and not for the values of the pair or set. Historical or antique value is not covered. This form is designed to insure private property, and while no coinsurance requirement is written into the policy, insurers require the insurance carried to represent approximately the actual values.

g) Wedding Presents Floater.—In order to protect wedding presents, wherever they may be and until permanently located, the wedding presents floater provides a world-wide coverage against all risks. The policy is written in three forms. The first of these is written with the 100 per cent coinsurance clause; the second, at an advanced rate, reduces the coinsurance requirement to 50 per cent; the third covers articles specifically scheduled at an agreed value, using the 100 per cent coinsurance rate but waiving the clause. In addition to the usual exceptions, loss or damage by moths or vermin is excluded, as is loss or damage occasioned by breakage, unless such breakage is caused by fire, burglars, thieves, or a transportation peril. Finally, the policy excludes loss or damage to accounts, bills, deeds, currency, money, notes, securities, livestock, automobiles or their appurtenances. To comply with the Nationwide Definition of the Insuring Powers of Marine and Transportation Underwriters, the policy must be written to expire not over ninety days after the wedding.

The foregoing coverages for which special forms have been devised by no means limit the scope of usefulness of the scheduled property floater. Other property insured under this form includes guns, trophies, surveyors' instruments, lodge paraphernalia, special exhibits, building cleaning equipment and other special machines, college gridiron tarpaulins, school colors, halftone screens, voting machines, neon signs, street clocks, false teeth, artificial limbs, and the like. Unless for some reason the property is deemed to be unin-

surable or unless a special form has been designed to meet the need, the scheduled property floater may be utilized to provide whatever coverage is needed.

Stamp Collection Floater. Privately owned stamp collections are covered under this policy against all risks, subject to the exclusions to be noted. In the form as usually written the policy covers postage stamps, including due, envelope, official, revenue including match and medicine stamps, covers, locals, reprints, proofs, and other philatelic property of the insured, including books and mountings.

Individual stamps may be scheduled, and when so covered, as to them the policy is valued. When the policy covers the collection under a blanket form, there is a limit of liability on any one item fixed at $250. The premium charge is based upon the fire rate for contents of the premises where the collection is ordinarily kept. To the fire rate a loading charge is added, but special rates are quoted when the values exceed $25,000. If the collection is ordinarily kept in a fireproof safe equipped with combination lock, a credit of 10 per cent off the total premium is allowed provided the following warranty is attached to the policy: "In consideration of the reduced rate at which this policy is issued the insured agrees to keep the property insured in a fireproof safe with combination lock when not in use or on exhibition."

In addition to exclusions relating to war, insurrection, and the like, the policy does not insure against infidelity of persons to whom the property is entrusted, loss or damage while on an aircraft during flight, or while in the hands of transportation companies unless sent by express, insured parcel post, or registered mail. "Mysterious disappearance" of individual stamps is not covered unless the stamps are specifically scheduled or unless mounted in a volume and the page to which they are attached is lost. With reference to injury to the stamps, the form specifically states that the following damage is not to be covered:

> Fading, creasing, tearing, thinning, transfer of colors, wear, tear, dampness, extremes of temperature, moths, vermin, and/or gradual depreciation and deterioration, and/or damage done during handling or while being worked upon and resulting therefrom.

Policies are usually written for a year, but when insurance is desired for a shorter period it may be written at the usual short rates. When insurance is desired to cover special exhibitions of stamps held by

clubs or like organizations, it is necessary to submit in detail all the attending circumstances, and a special rate applying to the particular risk is promulgated.

Radium Floater Policy. Radium is one of the most peculiar types of property ever made the subject of insurance. It is a rare substance, now widely used by the medical profession, particularly in the treatment of cancer. Because the substance is extremely rare, and the world's known supply widely distributed, infinitesimal amounts have a high value. While the market price of radium varies, in recent years its value has been approximately $70 a milligram. It is not uncommon to find values of $8,000 to $10,000 in a single capsule, and the amounts owned by the larger hospitals treating cancer exclusively have values of from $250,000 to $500,000 represented by from 4 to 8 grams. The largest single supply in the United States, said to be 8¼ grams, is owned by a Manhattan hospital. Amounts ranging down to a few milligrams are owned by scores of other hospitals.

In spite of the great care exercised in handling so valuable a substance, losses frequently occur. It is to indemnify the owner of radium in the event of its loss from any cause, war risks and gradual deterioration excepted, that the all-risks radium floater is written.

Because of the nature of the substance and the use to which it is put, it is important to notice certain clauses and conditions that are peculiar to this particular policy. The first of these is the requirement as to notice in case of loss. Although in most cases, the interpretation of the word "immediate," in connection with the requirement as to notice in case of loss, allows for some leeway, if radium is involved, the policy requires strict compliance with the requirement of immediate notice by telephone or telegraph, usually to the home office of the company. The reason for this requirement becomes apparent when it is realized that a trained radium expert with proper instruments may locate the lost radium. In some cases immediate action may make recovery possible, where delay would have put the lost radium beyond possible reach. Among instances of losses, in which the radium was subsequently located by an expert with an electroscope, were those resulting from accidents, such as throwing out the container with bandages or allowing it to be washed down a drain. The frequency with which lost radium is recovered in waste-pipes, when a brief delay would have meant total loss, indicates the necessity for quick action.

The policy is usually written with the patient supervision clause. This clause provides:

> In consideration of the reduced rate at which this policy is issued the insured agrees to use due diligence in the maintenance of uninterrupted care and supervision of each patient under radium treatment by a doctor, nurse, or other person specially designated to exercise such care and supervision.

Companies are reluctant to insure radium without this clause, and they issue such a policy, with an increase in the premium charge, only after satisfying themselves as to the care exercised in using the radium and the precautions taken to prevent loss. Radium covered by the policy must be individually itemized and so described that the insured item can be identified. Blanket insurance covering miscellaneous items is not written. Full coverage insurance equal to 100 per cent of the value must be carried; otherwise, the insured becomes a coinsurer for the deficiency.

Fine Arts Policy. Under this form, the owner of paintings, tapestries, sculpture, and other articles of rarity, historical value, or artistic merit may secure an all-risks coverage. In addition to the usual exclusion of war risks, strikes, and riots, other exceptions are limited to wear and tear and damage due to restoration or retouching.

The policy is used in insuring private or public collections of paintings, etchings, pictures, tapestries, valuable rugs, statuary, marbles, bronzes, antique furniture, rare books, antique silver, manuscripts, rare porcelains, rare glass, and other rare and valuable items. Special forms adapted to particular needs are available for museums, art galleries, dealers, or other commercial enterprises.

In the case of works of art, so much value is concentrated into comparatively small and easily damaged items that fire and burglary coverages are entirely inadequate. Friendly fires have caused losses not covered under the fire policy. Malicious mischief, prompted by revenge or other reason, is a frequent source of loss. Water and steam damage, explosion, windstorm, carelessness, damage caused by pets, defective building construction, accidents of various types, and hundreds of other unavoidable happenings may result in severe loss. Protection not otherwise obtainable is afforded by the fine arts policy.

There is no coinsurance requirement in the policy, but the form is valued, and each article to be insured must be described and scheduled with a separate valuation. Valuations are based upon an ap-

praisal made by competent parties, by the original bill of sale, or by the catalog price of the article. Blanket coverage is not written.

Policy forms are provided covering the insured items (*a*) in private homes, (*b*) in one or more specified places of exhibition, (*c*) in storage, (*d*) in transit, (*e*) under a floater form. Floaters, when written, may confine coverage to designated city or cities, to a state, or to the United States and Canada, the rate increasing as the territory is enlarged. Floater policies cover perils of transportation. Open forms are issued to art galleries, museums, or dealers, covering at specified locations or during transit. Under this form monthly reports of values are required.

Musical Instruments Floater. This policy is designed to provide a comprehensive coverage for musical instruments. The coverage is written on a broad form providing an all-risks coverage, and on a limited form insuring against loss or damage caused by fire, lightning, cyclone, tornado, flood, theft, and transportation hazards.

The coverage was originally designed to cover rare and costly instruments owned either by professional concert artists or by private individuals possessing such instruments. The business has now extended to cover all types of instruments, whether owned by amateurs or professionals. Miscellaneous equipment used in connection with the instruments, such as music, cases, racks, and the like may be insured with the instruments blanketed, with the 100 per cent coinsurance clause and limited to 10 per cent of the face of the policy. Otherwise, each item must be scheduled and valued.

The all-risks policy excludes loss or damage caused by any process of refinishing, renovating, or repairing; by dampness or atmosphere or extremes of temperature; by wear and tear or gradual depreciation; by infidelity of the insured's employees or persons to whom the property is entrusted; and by civil commotion, riots, and war. In addition to the foregoing, the limited form excludes loss or damage to the property insured while in an automobile unless in the custody of a common carrier.

Most policies are written with the 100 per cent coinsurance clause, though this may be eliminated in special cases. When no coinsurance requirement is written into the policy, insurers require insurance in an amount approximately equal to the values insured. In preparing the schedule, some substantiation of values, such as a bill of sale or appraisal, is necessary. Depreciation is deducted when instruments

are not new, with the exception of violins and cellos, which may be covered up to the cost price to the insured. If the instrument is old and rare, an appraisal is the satisfactory way to establish values.

Bailees' Customers Policy. Possession of personal property is often temporarily surrendered by the owner with an agreement for its subsequent return. Such an agreement is known as a "bailment," the owner of the goods is the "bailor," and the one to whom possession is given is the "bailee." In the case of a bailment, title to the property remains with the bailor, temporary possession and control of the property with the bailee, and ultimate possession with the bailor.

In connection with bailments, the question arises, since title remains with the bailor and possession and control pass to the bailee, as to which of the two is responsible in case of loss or damage to the property. When the bailment is for the benefit of both bailor and bailee, provided ordinary care is exercised by the bailee, it has been held that any loss or damage to the property follows the title of the property and hence falls upon the bailor. The bailee is held to have exercised ordinary care when he uses the same care that an ordinarily prudent person uses in connection with his own property. If, therefore, goods are left for some service to be performed, as at a laundry or cleaning and dyeing plant, the owner of the plant is not liable for loss or damage unless negligence can be shown.

Business houses, however, have been apprehensive of the loss of goodwill in the event that customers' property should be destroyed by fire or lost or injured through any other cause, and accordingly have sought insurance. To meet the need, the bailees' customers form has been provided, which covers loss or damage to customers' property, whether or not the bailee is legally liable for the loss. Three forms of the coverage are available; the first for laundries, the second for dyers and cleaners, and the third for rug and carpet cleaners.

The three forms are alike in their essentials, varying in details to fit the needs of the particular business. The usual perils insured against are fire, explosion, collision, theft, burglary, holdup, tornado, cyclone, windstorm, flood, sprinkler leakage, transportation risks by public carriers or mail service, earthquake, strikes, riots, civil commotion, and, in the case of laundries and carpet cleaners, the confusion of goods resulting from any of the foregoing perils. The usual exclusions are theft or shortage of individual pieces or articles unless by

burglary or holdup; loss or damage to goods in the custody of other laundries; loss or damage to goods held in storage; or loss if other insurance covers.

Protection is provided on all kinds of lawful goods or articles, the property of customers accepted by the insured for cleaning, pressing, laundering, or other like service while contained in the premises occupied by the insured or used by its agents, and while being transferred to and from its customers or between its own branches or agencies. The liability of the company is limited to the actual cash value of the property destroyed, with no limit set for any one disaster. Provision is made in the policy to cover the insured's charges for services rendered on the lost or damaged items.

The premium is based upon the gross income of the business insured, and monthly reports are required indicating the gross earnings for the previous month, whether collected or not. The contents fire rate is used as a basis for establishing a rate.

FOR REVIEW

1. The state of Connecticut owns Gilbert Stuart's life-size portrait of George Washington. This work of art has been appraised at $250,000. Would the fine arts floater policy cover loss to this picture occasioned by the malicious throwing of acids upon it?
2. Mrs. X through a trade connection has been enabled to buy a fur coat at a sum of 30 per cent less than the retail value. She makes application for a fur coat policy for the full retail value, on the grounds that if the coat is lost she will be obliged to purchase a new coat at a retail store. May she secure such a policy?
3. A businesswoman drove to a distant city with a valuable fur coat in a box on the back seat of her automobile. It was her intention while in the city to leave the coat with a furrier for alterations. Stopping to accompany a friend on another errand, she parked her car, locked the doors, and after trying them left the car for approximately forty-five minutes. Upon her return she noticed that the box had been moved and upon examination found one of the doors open. The coat had been stolen. The police were unable to find any trace of the coat. Is the loss covered under the fur coat floater?
4. A young woman living in an apartment building noticed a closet door open and upon examination found that her fur coat had been stolen. Apparently the thief had just left the apartment, and when the alarm was aroused he sought escape through the cellar. In an effort to dispose of the incriminating garment he threw it into an incinerator where it was damaged beyond repair. Does the fur floater policy cover the loss?
5. The insurance manager of a large mercantile corporation recently stated that credit sales are growing so tremendously in volume and so grave is the danger

of congestion in values that an insurance coverage of the risk is necessary. He is quoted as saying: "Our theory is that if another great conflagration occurs, many customers will be unable to meet their payments, and there will be a strong disposition on the part of the customers buying merchandise on deferred payments to salve consciences by pleading that they do not feel that they should be called upon to pay for something which was not fully theirs at the time the loss occurred." What form of coverage will provide adequate insurance, and what type of concerns need it particularly?

6. X, a general contractor, is working on an excavation job and a landslide ruins a substantial part of his equipment. In your opinion is this a loss under the contractor's equipment policy?
7. Define "bailee," and distinguish between the responsibility of a gratuitous bailee and that of a paid bailee.
8. Under the rug and carpet cleaners bailee form, in what circumstances would the theft of a valuable oriental rug not be covered?
9. In a recently reported fire in Boston more than 200 bundles and packages of laundry were destroyed. It is represented that most of the laundry damaged and destroyed by the fire consisted of towels, sheets, and other items sent in as wet wash. Assuming that the laundry was entirely free of neglect and there was no liability on the part of the owner of the laundry to make good the loss to the individual customers, is there nevertheless an insurable loss to the laundry because of the damage to the packages?
10. Which of the following perils are covered under the laundries' bailee's customer's insurance form?
    1. Fire
    2. Lightning
    3. Explosion
    4. Upset of transporting vehicle
    5. Damage by hail
    6. Flood
    7. Sprinkler leakage
    8. Riot
    9. Shortage of individual pieces
    10. Items sent out by other laundries
11. Mrs. S while shopping arranges to take two dresses home for examination. On her way she stops at the home of her friend, leaving the packages containing the dresses in her unlocked car. While she is visiting her friend, the packages are stolen. She now makes claim under the personal effects policy. Is the loss covered?
12. X carries a personal effects policy. Under its terms, in your opinion, would an artificial limb be covered?
13. Y is insured against all risks under a personal effects policy. While abroad, stopping at a hotel he loses a watch. Upon his return home he makes a claim under his policy, stating that he had kept the loss secret in an effort to trap the thief. Is the loss covered?
14. The baggage of Mrs. X is valued at $6,000. Included are two pieces of jewelry each valued at $2,500 and a fur coat valued at $1,000. What coverage is afforded under the personal effects policy?
15. X insures two suitcases containing linen, lace, and other valuable pieces of merchandise under a form which reads "on trunks and samples of merchandise." The owner of the merchandise was in the habit of selling the articles

from time to time, replacing them with duplicates. Following a loss, the insurance company denied liability on the ground that the goods insured were not samples. In your opinion, was the insured properly covered?

16. A sample case insured under an all-risks salesmen's floater is lost. The insurance company, contending that a sample is "a fair representation of the whole," offers to settle on the basis of the cost of the items as they appear in the insured's stock of merchandise. The insured contends that extra expense was put into making the samples and, in addition, claims that he should be reimbursed for the original cost of their designing. How should this loss be settled?
17. X, an employee of B's hotel, allowed a trunk being transported from the railroad terminal to become wet, destroying $300 worth of clothing. B denies liability on the ground that the truckman was negligent. Is B liable and, if so, is the risk insurable?

PART IV

CASUALTY INSURANCE

Chapter XXV

THE LIABILITY RISKS

LIABILITY Insurance Defined. In contrast to direct damage insurance, which indemnifies the insured when the loss is the outgrowth of injury to his own person or property, liability insurance policies do not cover loss or damage to the person or property of the insured but cover instead the liability for damages imposed by law. To come within the coverage of the policy, the damage must be the outgrowth of an accident. Bodily injury, including death and injury to or destruction of property, come within the scope of the cover.

In writing liability insurance, insurance underwriters separate the property damage from the bodily injury covers. Hence, the liability insurance field is divided into two major classifications: (1) bodily injury liability insurance, and (2) property damage liability insurance. A large number of liability policy forms are offered by insurance companies providing insurance protection against liability growing out of the class of accidents described in each policy. The most recent development in the liability field is a comprehensive policy, designed to include all the known exposures of the insured, as well as losses that may grow out of unknown and unforeseeable exposures.

In the insurance contract there are two parties to the agreement—the insurer and the insured. In the case of direct damage insurance, the insured receives payment from the insurance company to indemnify him for a loss. In the case of liability insurance, the party who is injured or suffers a loss to his property is not the insured and, hence, is not a party to the contract. Because of this, liability insurance has sometimes been termed "third-party insurance." The term is entirely in order, but in using it one should remember that the third party is not an insured and has no right of action against the insurance company.

Crime and Tort. The law recognizes two classes of wrongs. If the wrong is the violation of a public law for the protection of the public and is punishable by the state in its own name, the wrong is termed a "crime." Contrasted to crime is the private wrong or civil injury termed in law a "tort." A tort is an infringement upon the

civil rights of individuals, whereas a crime is a violation of rights that affects the entire community.

The state punishes persons found guilty of crime by means of fines, imprisonment, or both, or by death. Persons accused of crime are held in this country to be innocent until the contrary is proved, but the expense of the defense frequently involves large sums of money. Liability policies assume no responsibility whatever for expenses or loss occasioned by the commission of a crime.

A tort involves an interference with the rights of the individual, and as such involves no action on the part of the state, but makes the wrongdoer, who is known as the "tort-feasor," liable for damages to the injured party. The action on the part of the state to effect the conviction of a person charged with a crime is termed a "criminal action," while that of an individual seeking to collect damages because of a private wrong is termed a "civil action." Since a crime may be both a public and a private wrong, as in the case of manslaughter, two separate cases may be the outgrowth of an automobile collision—the criminal action initiated by the state, and the civil action initiated by the injured parties. It is with the defense of the civil action and the settlement of this claim that the liability insurer is concerned.

Requisites for Liability. To do a wrong, the act or omission must be voluntary. Thus, if a person in the course of saving himself from great danger injures another without intent, there is held to be no voluntary act and hence no liability. On the other hand, it is no defense if the act which injures a party was done without intent to do an injury or if the motive behind the act was good and praiseworthy.

A second requisite for the fixing of liability is found in the rule that the voluntary act of the wrongdoer must have been the proximate cause of the injury. To be held a proximate cause there must have been a continuous succession of events from the causal act to the final event causing the injury. If there was an independent and intervening cause, the continuous succession of events was broken. Neither a natural force nor the involuntary act of another is held to be an intervening cause. Thus, a fire negligently ignited and spread by the winds is one continuous succession of events. If a third party, while watching the fire, were deliberately pushed into the flames and injured, there would not be a continuous sequence, and no liability for the injury would attach to the party responsible for the fire.

There is a phase of negligence that introduces the rule of pre-

sumptions. In order to establish a case, the claimant in ordinary circumstances must show a failure to exercise reasonable care. The burden of the proof, therefore, is on the claimant. In certain cases, however, negligence is presumed from the facts. The legal doctrine which applies—*res ipsa loquitur,* "the thing speaks for itself"—establishes a prima-facie case of negligence if the injury was caused by an inanimate object within the control of the defendant, when common experience has proved that such objects cause injury only when there is negligence. A brick falling from a building would be an illustration. It is to be pointed out that a prima-facie presumption may be rebutted; that is, the defendant may still have his day in court and prove absence of negligence. The effect of the presumption is to shift the burden of proof, relieving the claimant of the necessity of establishing negligence and obligating the defendant to prove its absence.

Servants and Agents. Aside from the responsibility that attaches to the individual wrongdoer when he acts in the capacity of agent or servant of another, the responsibility may also attach to the principal or master. Thus, the principal or master becomes liable to third parties for damage caused by the negligence of an agent or servant, so long as the agent or servant is acting within the scope of his authority or engaged in the business entrusted to his care. The severity of the rule is recognized when it is found to apply, fixing liability upon the master or principal, if the wrongful act committed in the course of employment is contrary to express instructions. For example, if a bank messenger is forbidden by his employer to use his car during business hours and, contrary to orders and in the course of his employment, uses the car and accidentally kills a man, the bank may be held liable for the tort of its servant. It is definitely settled that the principal cannot escape responsibility by showing that the agent acted contrary to his orders, nor can he avoid liability by showing that his agent was doing work other than that which he was instructed to do.[1]

[1] When the injured party seeks to hold the master or principal for the wrongful act of a servant or agent, there are three points to be determined. First, it must be shown that a tort was in fact committed. Second, it must be shown that the wrongdoer was actually a servant or agent. Finally, it must be shown that he was acting within the apparent scope of his authority and in the furtherance of his master's or principal's business when the wrong was committed. For instance, it has been held that if an employee steps aside from his business, however brief the time, and during this interval wrongs another, there is no responsibility on the part of the employer. The possession

Parents' Liability for Children's Acts. A child acting in such circumstances as to constitute himself the agent of his parents is subject to the law of agency and thereby may commit a tort for which his parents are liable. In the relationship between parent and minor child, the law goes one step further. Parents have been held negligent, and therefore liable, when children have been given possession of dangerous instrumentalities.

While parents are frequently involved in litigation as the outgrowth of acts of children committed without any apparent malicious intent, it is to be emphasized that the parent is not legally liable for all the acts of his minor children, and the child may himself be liable for his own wrongful acts. It is, therefore, entirely possible that a child be legally liable for, but unable to meet, damages in a situation in which the parent cannot be held liable. There is a difference between the liability of a parent for acts of his minor children and the liability of the children themselves for their own acts. In liability policies in which the contract itself does not extend to cover the liability of children, if the insured wishes this coverage as well as protection for his own liability for their acts, he should have the policy endorsed accordingly.

In the matter of automobile accidents, when the car has been negligently operated by a minor child, parents have been held liable under a legal theory that has come to be known as the "doctrine of the family automobile." The reasoning behind the conclusion that the parent is liable does not in every case follow the same line. Sometimes the conclusion is based upon the doctrine of agency, again upon the ground of dangerous instrumentality, and yet again upon the theory that the car was furnished for the family and that any liability arising from its intended use should attach to its owner.

Animals. The keeping of a mischievous animal with knowledge of its propensities is a basis for absolute liability. The element of knowledge, to which the law applies the term *scienter,* is essential in the case of animals ordinarily held to be harmless. In this group are to be found pets and other domestic animals. Wild animals, such as are to be found in a menagerie, are kept at the owner's peril, and the

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of the employer's car or other vehicle is not sufficient to hold the employer liable for the employee's tort, nor is the employer freed from liability if the employee combines his own business with that of his employer. The test of liability is said to be found in the affirmative answer to the question: "Was the servant engaged in the apparent furtherance of his employer's business?"

liability is absolute, regardless of diligence or absence of fault. To fix liability upon the owner of a domestic animal, the beast need be neither vicious nor ordinarily classed as dangerous.[2]

Trespasser, Licensee, and Invitee. In the case of property owners, the prudence and diligence required differ with respect to the position occupied by the person entering upon the property. The law divides such persons into three classes: (1) trespassers, (2) licensees, and (3) invitees. One who goes without any right upon the lands of another is a trespasser. One who enters upon another's lands with permission expressed or implied is a licensee. One who is expressly invited to enter and comes in the interest of the occupier of the property as well as his own is an invitee.

It is held that trespassers take the risk of defects in the premises, whether they be hidden or open, but that trespassers cannot be intentionally injured by a trap or otherwise. The licensee likewise takes the premises as he finds them, but with this difference: he has the right to expect the occupier of the premises to warn him of any hidden dangers. The invitee, on the other hand, may hold the occupier of the premises liable for any loss or damage caused by a defect which, though unknown to the occupier, is of such a nature that a reasonable and prudent man would have discovered it by exercising reasonable diligence.

Negligence. Negligence is a tort for whose consequences the wrongdoer or negligent party is liable if negligence is the proximate cause. More than this, if the negligent party is an agent, servant, or employee, in accordance with the rule of law already noted, the injured party may elect to hold the principal, master, or employer liable. Therefore, one may find himself liable for serious injury to the person or property of another either through his own act or through the act of another over whom, for the time, he had neither direct oversight nor control.

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[2] In a case decided in the Supreme Court of Vermont, an old man called at a farmhouse to buy potato seed. A young mastiff ran to meet the visitor and, jumping up, put his paws on the old man's shoulders. The visitor fell and broke his leg. Suit for damages was brought, and defended on the ground that the dog was only playful and that the owner could not be liable unless the dog was vicious and he (the owner) had knowledge of the fact. The court held that it was sufficient to fix liability if the owner knew that the dog was rough at play and might reasonably commit the injury complained of.

Runaway horses have been the cause of damage for which the owners have been held liable.

Negligence is the failure on the part of an individual to exercise the proper degree of care required by circumstances. It may consist in the failure to do what was required under the circumstances, or it may consist in the doing of something that ought not to have been done. Behavior in any circumstances that fails to measure up to that expected of a careful, prudent person in like circumstances constitutes negligence. It can readily be seen that faulty judgment may result in liability for negligence, even though the motive behind the act was the best.[3]

Contributory Negligence. Except where statutory enactments have modified the rule, anyone who seeks to hold another liable for negligence and who has himself been negligent has no legal basis for his claim. This is due to the common law rule that anyone who is himself so negligent as to contribute to the injuries or damage complained of cannot recover from another for these injuries. Such a person is said to be contributorily negligent and is prevented from recovery because of contributory negligence.

In cases in which contributory negligence is alleged as a basis for denying liability, the claimant frequently advances the plea that the alleged contributory negligence was in fact not a proximate cause of the accident and, therefore, did not contribute to the injury. It is contended that in spite of the alleged contributory negligence of the claimant, had the defendant exercised reasonable care, he could have avoided the accident. As a result of such contentions there has developed a rule known as the "doctrine of last clear chance," which holds that, although the claimant is negligent, liability nevertheless attaches to the defendant if he had a last clear chance to avoid the accident.

Attractive Nuisance Hazard. There is a line of decisions, not all in agreement, however, known to lawyers as "turntable cases." A decision of the Supreme Court of Minnesota (*Keef* v. *Milwaukee and St. Paul Railway Company,* 21 Minn. Rep. 207) in 1875, held that a boy injured by a turntable was not in the position of a trespasser. It

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[3] Reference to the circumstance indicates that the degree of care necessary to escape the charge of negligence varies. For example, a surgeon setting a fractured limb must exercise an entirely different degree of care from that exacted of a tailor fitting a suit of clothing. Likewise, the care required of a pharmacist compounding a prescription for dangerous drugs is of a different degree from that required of an individual packing food products. Yet in each case there may be negligence for which the negligent party may be liable for heavy damages.

was held that the turntable so strongly attracted young boys that they were induced to play upon it, and, this fact being known to the railroad, it was bound to use ordinary care to protect them from harm.

The original theory held that any person who maintained a nuisance visible from the highway that, because of its nature attracted and allured children, was liable for injury to children playing with or near it. This has since been modified by the decisions so that now the object in question need not be of itself a nuisance, nor need it be actually visible from the highway. To constitute an attractive nuisance, it is sufficient if it is attractive to children and dangerous to them. The "doctrine of attractive nuisance" holds the owner or tenant of a property obligated to exercise reasonable care in the protection of children in cases where they might through attraction be injured.

Objects that might become attractive nuisances are contractors' equipment, such as concrete mixers, cranes, and the like. Again, ladders on light poles, artificial pools, mill property, machinery of any description, unguarded hoists, elevators, and scores of other properties may all give rise to liability claims on the attractive nuisance theory.

The Liability Risk. The owner of a property knows the limit of direct loss. This limit is the value of the property. Thus, a building that cost $10,000, if completely destroyed, will result in a loss to the owner of $10,000. An automobile that cost $3,000, if stolen and never recovered, represents a loss of no more than $3,000, plus any expenses incurred in an effort at recovery. In the case of liability claims, the limit is not marked by the value of the property involved and, as a matter of fact, may not be fixed with any reasonable certainty.[4]

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[4] The files of every insurance office are filled with cases involving enormous verdicts. A typical example is found in a verdict of $75,000, awarded by a Minneapolis jury as a result of an automobile accident which cost the claimant the loss of an ear and the impairment of his senses of sight, smell, and taste. An Illinois Superior Court awarded a verdict of $55,000 in favor of a woman who was injured by a baker's truck, which was struck by a train. The jury found negligence. In Illinois a doctor who contended the other driver was at fault was forced to pay $20,000. In Kansas a seventeen-year-old boy, claiming permanent injury as a result of a car's backing into him and breaking his leg, was awarded $12,500. A verdict of $50,000 was awarded a young lady in Brooklyn who claimed that she would be obliged to use crutches for the rest of her life, thus ending a professional career. The list could be carried on indefinitely.

Nor are claims for negligence limited to automobile accidents. Owners of real estate likewise are forced to pay heavy damages in spite of every precaution. In St. Louis, in October, 1932, a brick struck a woman on the head when it fell from a building into a

Churches are not immune from suits. Their activities in recent years have become diversified, with the result that they are exposed to claims by persons having no immediate connection with the institutions themselves. Present at almost every service in many churches are visitors who would be quick to ask damages in the case of injury. But claims are not restricted to strangers, nor are the sums claimed modest in amount.

Hotels and restaurants are liable for sickness or injury caused by the products they handle, as are stores and packers of foods and medicines. Suits based upon alleged negligence are frequently brought against druggists, physicians, surgeons, and dentists. Claims running into enormous sums are contantly being paid. The public is becoming liability-minded, and rare indeed is the accident that is not made the basis of a claim for damages. It has been well said that the verdict is a "highly variable and potentially ruinous danger."

Nonownership Liability. It is in connection with the ownership and operation of automobiles that some of the most perplexing questions of liability are presented. In the absence of specific statutes providing the contrary, it is the rule that when a car owner lends his automobile to another, who uses the car for his own purposes, the car owner is not called upon to respond in damages for injury arising out of the operation of the car. On the other hand, if the operator of the

crowd gathered to see a parade. As a result of the injury, she obtained a judgment of $30,000, and her husband obtained $22,191.

There is on record the case of a workman on a hotel who dropped a hammer, breaking a window across the street. Flying glass seriously injured a twenty-three-year-old girl, with the result that a verdict of $102,427 was awarded against the owners of the hotel. Following an appeal, the case was settled out of court for $77,000. A cash register drawer in a grocery store struck a customer a sharp blow in the chest. Cancer followed, and a verdict for $50,000 was decreed against the store owner. A customer in a department store slipped on a recently oiled floor and recovered $15,000. A high school student who lost an eye in an accident in the school welding shop was awarded $30,000 against the high school district and board of education. A woman entering a revolving door of a department store was injured and was awarded $10,000 against the owner of the building.

Claims are constantly being made against owners of business property such as apartment houses, bank and office buildings, stores, and factories. But they do not stop there. A representative of a millinery establishment in Rochester fell on the steps of a residence and brought suit for $3,000. A person slipped on a rug in a residence in Akron, Ohio, and collected several hundred dollars; in another case a guest, who slipped in a bathroom and suffered a broken hip, brought suit for $16,000. A fall down a flight of stairs by a visitor brought a suit for $10,000 against a Greenwich, Connecticut, man; a charwoman who fell from a stepladder was awarded a verdict of $8,500 in Minneapolis, while a property owner in New York had to pay a fireman $30,000 for injuries which he received in an explosion. Sidewalk accidents and injuries to deliverymen, servants, and guests all involve liability on the part of the property owner.

car doing the damage occupies the position of servant or employee, the owner of the automobile is held liable.

Thus, a car owner is responsible for the conduct of a chauffeur while on the business of, or engaged in furthering the interests of, his employer. The most difficult problems arise when an employer is held liable when the car is neither owned, leased, nor hired by him. For instance, the employee of a laundry or grocery store delivers a package on his way from work riding in his own car; a bank employee or director goes out to inspect property using his own automobile; a collector or subscription solicitor for a newspaper, an employee of a contractor going from one job to another, a salesman, reporter, collector, or scores of others acting in their employers' interest and driving their own automobiles may involve their employers in huge accident claims. The danger is particularly acute in that the employee may have very little, while the employer is a logical target at which to aim heavy damage suits.

Liability Claims Involve Future. Direct loss or damage to property destroys values already acquired, but a liability claim may destroy more by obligating the party held responsible for the loss or injury to make payments for years in the future. Cases are on record in which individuals who believed themselves to be judgment-proof were obliged to readjust their entire standards of living and make weekly payments out of their incomes until judgments were satisfied. Cases are also on record in which individuals, because of liability claims, have faced a program of personal retrenchment over a period of years in order to pay in installments, out of earned income, the damages awarded against them. Because of the size of verdicts now being awarded in damage cases, it is at once apparent that a court judgment may reach out to take bank deposits, securities, real estate, and, in addition, a part of one's earnings for years to come.

Bankruptcy has sometimes been suggested as a way out. This is not altogether a simple procedure, and the consequences in the way of injury to business reputation and credit standing amount to a lasting injury. Even this process of avoiding a legal obligation is being brought to an end through legislative enactment. In many states any person failing to satisfy a judgment for damages in an automobile case faces the possibility of a jail sentence. Visitors to states having laws different from those of their home states find themselves involved in suits and subject to the law of the place where the accident occurs.

The Faked Claim Hazard. During the past few years individuals and gangs have been causing great loss and annoyance through the making of fraudulent claims for alleged injuries. A number of such individuals and gangs have been apprehended, but the menace has grown to such proportions that casualty companies, it has already been noticed, have organized, under the auspices of the National Casualty and Surety Underwriters, central index bureaus in different sections of the country for the filing and tabulating of casualty claims. This system brings to light duplication of claims for the same alleged injury, and the frequency with which the names of doctors and lawyers appear in connection with doubtful claims "spots" them for observation.[5]

Because of the facilities possessed by the insurance companies for checking up such claims, property owners and businessmen have sought the services of the professional insurance adjuster through the purchase of the liability policy.

Aside from the professional fakers of claims there are the amateurs to be considered. In this group are to be found persons who measure damages, not by the extent of the injury, but by what they can get. When involved in any accident, however slight, they go to bed immediately and experience all kinds of symptoms. These cases stubbornly refuse to yield to the most expert medical treatment until after a satisfactory financial adjustment has been effected. The recovery then is phenomenal. Cases of this type, where the injury is slight or frequently where there is no injury, have cost property

[5] Faked claims are made in almost every conceivable situation. Sometimes they are made in such a manner as to prompt a quick adjustment to avoid unfavorable publicity. An example in point is the case of the man who often carried a dead mouse in his pocket. Going into a restaurant, he would order a chicken pie. After eating a part of it, at a favorable opportunity he would slip the mouse under the pastry and leave it there until it was well soaked. Watching until a waiter was at hand, he would open the rest of the pie and "discover" the dead mouse presumably cooked therein. To avoid any possible scene, settlements were promptly made.

Another case run to earth by the insurance companies was that of a man who would swallow a nail or a tack in a restaurant and allege it to have been in the food. X-ray pictures would be presented in due course, and damages claimed and paid. His fraud was finally brought to light by the insurance check-up.

Another case was that of a person who could throw a shoulder out of place at will. He would choose a high-priced automobile, and with his own witnesses and an occasional innocent bystander present, he would stage an "accident."

Still another man carried a broken tooth for which he frequently charged restaurants $25, alleging that he had broken it biting some hard substance found in the food.

Packers of canned goods have been victimized by claims resulting from alleged illnesses caused by eating their product.

owners hundreds of thousands of dollars. Every claimant knows that it is expensive to contest a suit and that the defendant, disliking the attendant publicity, prefers a settlement even when he knows he is being held up. Payment of claims of this type, when there is no liability or when claims are in excess of the damage, is termed "buying one's peace." Such settlements are not easily effected by one inexperienced in the adjustment of liability claims.

Liability and Financial Responsibility Laws. In connection with the operation of an automobile, legislative enactments have extended the liability of the car owner. At the end of 1946, thirty-six states and the District of Columbia, Hawaii, and seven Canadian provinces had enacted financial responsibility legislation, and in other states similar laws were receiving consideration.

Financial responsibility laws differ from state to state in detail but are alike in principle. Instead of requiring a motorist to purchase insurance or otherwise establish himself as able "to respond to damages" before his car is licensed, the laws operate on the principle that once a motorist has demonstrated himself to be a careless driver, through the violation of some regulation or by becoming involved in an accident for which he is found liable in either a criminal or a civil court, he must prove his financial responsibility or lose his license to drive.

Three courses are open to the car owner to meet the legal requirements for financial responsibility. He may produce evidence that he carries insurance of the type and in the amount required; he may file a surety bond; or he may deposit cash collateral. Most of the states require $5,000 limits for an injury to an individual, with an upper limit of at least $10,000 in a single accident, and a limit of at least $1,000 for claims for property loss. Surety bond requirements range from $2,000 to $11,000, or, where cash collateral is submitted, the requirements range upward from $6,000.

Laws of this type, when first passed, provided that proof of financial responsibility be furnished by the owner of a motor car after he was convicted of a motor vehicle law violation. Financial responsibility for the future only was required in case of a failure to pay a final judgment or conviction of traffic violation. Laws in this category do not require the satisfaction of outstanding judgments, but merely proof of financial responsibility for the future.

In the course of time, laws were passed which required suspension

of the operator's license, or registration plates, or both, in the event of a failure to pay a final judgment. License is suspended until the judgment is satisfied and proof of financial responsibility is established for the future. More recently the tendency has been to broaden the laws. The latest type, usually referred to as the "New Hampshire–New York" law is indicative of the trend in financial responsibility legislation. The law first appeared in New Hampshire and was later enacted in New York. This law requires motorists, involved in an accident, immediately, to provide security to cover any possible judgments up to specified limits that might result from that accident. There is no provision for waiting for the application of the law until after conviction of a violation is handed down from a court or until the motorist fails to pay final judgment. A number of states that had enacted financial responsibility laws of the more lenient type have repealed previous legislation and enacted laws based on the New Hampshire–New York plan.[6]

Financial responsibility laws affect nonresidents as well as residents of the state where the law has been enacted. More than involving a driver in a maze of legal difficulties and technicalities while he is distant from home, the difficulty may have legal reverberations in his home state. Where reciprocal agreements exist, the failure on the part of a motorist to pay a judgment in a neighboring state may definitely affect his standing at home.

Because of the legal technicalities involved and the uncertainties concerning the operation of the different laws, motorists have turned to insurance to assume their legal liabilities. Without going into detail as to every legal requirement, they have satisfied themselves that their policy is so drawn by experts as to meet their needs.

Compulsory Insurance. In contrast to the financial responsibility laws enacted in the majority of the states that have legislated in the field, Massachusetts has gone one step further and made the demonstration of financial responsibility a condition precedent to obtaining registration. All owners of automobiles are required to produce an

[6] Indicative of the "teeth" in the New York law it is reported that in a single year (1944) there were 35,735 safety responsibility suspensions. Of these, 26,619 deposited securities or made settlements with the claimants or furnisned a release in lieu of security. The difference of 6,116 indicates the number of persons whose right to drive was suspended. The aggregate deposit of securities by motorists in that year were $1,058,533.

insurance policy, bond, or collateral before license and plates will be issued.

Since the enactment of the law in Massachusetts in 1927, there have been two schools of thought concerning the subject. Advocates of compulsory insurance point out the danger of a serious accident when an uninsured and financially irresponsible driver is liable for damages and unable to pay. In such a case, the financial responsibility law, they contend, offers no assistance for past accidents. As a guarantee of protection to the public against financial loss, compulsory insurance is held by its advocates to be superior to the usual financial responsibility law. Opponents of the law contend that it tends to accelerate recklessness, thereby causing more accidents instead of lessening them. Insurance companies have little opportunity to select their risks, and the loss experience is disheartening. Claim suits tend to increase abnormally, the courts are congested, and rates are abnormally high as a result of unfavorable experience. There is also a belief that property damage claims are converted into bodily injury claims, since only the bodily injury coverage is required by law. To what extent these contentions in opposition to the plan are valid, it is not always possible accurately to determine because of the absence of adequate data. Studies have been made, however, that would indicate no connection between the effect of compulsory insurance and the motor vehicle accident rate.[7] The Massachusetts law, however, has not been a popular one and since it came into operation in 1927 no other state has followed with a similar type of legislation.

Modified forms of both compulsory and financial responsibility laws have been advocated. It has been suggested that each insured be obliged to bear the first $100 of any claim. Another form provides payment for all injuries regardless of liability upon a predetermined scale. Until such laws have been written into the statutes of some state, their interest is academic only.

Liability Insurance Not Accident Insurance. Liability insurance does not undertake to make good the loss or damage caused by the insured. Rather, it undertakes to defend the insured when claims are made against him and, if he is legally liable for the loss or damage, to

[7] Blanchard, Ralph H., "Experience under the Massachusetts Compulsory Automobile Liability Security Act," *Chicago Journal of Commerce*, January 24, 1941.

settle with the claimant on the best terms possible. The liability insurance policy undertakes to make such payments to injured persons, or to the owners of damaged property, as the insured would himself have been obligated to pay because of the liability imposed by law. If investigation indicates no liability, it does not alter matters if the insured feels in a particularly generous frame of mind and wishes a prompt and generous settlement. The insured in justice cannot contend that he is paying a premium for such a settlement. Briefly stated, if there is no negligence on the part of the insured, and hence no legal liability, there is no obligation on the part of the company to make any payment to a claimant. The company, however, is obligated to defend the insured against groundless claims, to bear the expenses thereof, and to make settlements subject to the limits of the policy in the event of unfavorable verdicts.

In cases in which the question of liability is not clear, the insurer may, and frequently does, make a settlement. By so doing, the company saves the expense of litigation, and the insured is spared the inconvenience attendant upon a trial. The option of making such a settlement rests with the insurance company or its representatives.

FOR REVIEW

1. X is an employee of the federal government and drives a postal truck. Since the federal government may not be sued, the claim is made that the driver of the truck, while acting in the capacity of a servant of the federal government, may likewise not be sued. Is this contention correct?
2. Mrs. M was shopping in the X department store, and a salesgirl accidentally stepped upon her foot, breaking the skin. The customer did not believe the accident to be serious and shortly after left for a vacation. Before her return, blood poisoning developed. The woman brought suit and her attorney contended the store to be liable on the ground of negligence. What is your opinion?
3. The agent of a large life insurance company on the way to attend a convention meets with an automobile accident, and a passenger riding with him is seriously injured. The life insurance company has no interest in the automobile and no knowledge of the passenger. In your opinion, if the agent was negligent in the operation of the car could the insurance company be held liable?
4. The Blank Construction Company frequently hires trucks on an hourly or periodic basis. It exercises no right to direct the driver, nor does it have any financial interest in the cars. Following a severe accident the construction company contends that the owner of the car is an independent contractor, and for this reason the car owner is liable for any damages and the construc-

tion company can under no circumstance be held liable. What is your opinion?

5. B is a resident of California. He became involved in a slight accident in New York and, because he believed the other party was liable, refused to make any financial adjustment and continued on his way. It was his idea that, once safely out of the state, he was beyond the reach of the New York courts. What feature of the financial responsibility laws would have bearing on such a case?
6. C is a resident of New Mexico. As a result of an automobile accident in Maine, judgment is rendered in an amount of $4,000. C leaves the state of Maine feeling the judgment to be uncollectible since he has no property in Maine. What is your opinion?
7. What are the marks that distinguish the independent contractor from the servant?
8. The Hope Funeral Parlors allow the friends of the family of a deceased person to donate automobiles for use in funeral processions. One such car slips over an embankment in a cemetery and seriously injures four passengers. The owner of the car carries no liability insurance and suit is filed against the funeral director. In your opinion, is there any possibility that the funeral director will be obligated to pay the damages?
9. B, a bank messenger, purchases for his own use a secondhand automobile. His employers discover the ownership of the car, forbid him to use this automobile at any time upon the bank's business upon the pain of dismissal. B is delayed at the bank one afternoon and, in order to carry a package of bonds to the post office before the registry window closes, uses his own automobile but without the knowledge of his employers. On the way to the post office he strikes and kills a child. Suit is filed against the bank, and the bank denies liability on the ground that it had expressly forbidden the employee to use his automobile in the course of business. In your opinion, may the bank escape liability?
10. Imprisonment for debt is generally outlawed by the constitutions of the various states. In spite of this, in a large number of our states a person who fails to pay a judgment rendered against him as a result of an automobile accident may be placed in jail until he does pay. How are the two statements reconciled?
11. A customer eating in a restaurant alleges that he has been ill because of having been served spoiled sardines. An examination of the food shows that the sardines were not spoiled, and the claim is obviously a fake. Suit is filed. Is the insurance company covering the risk obliged to defend a suit in a fake claim?
12. R. M., a student of fifteen years of age, had an eye injured as a result of the explosion of a pressure gauge in the school laboratory. Do you feel that there is any legal liability on the part of the town board of education?
13. The president of a large corporation in the course of performing his duty directs the placing of certain light poles. One of them falls and seriously injures a member of the public. The claim is made that the president is

personally liable for the damage, but the president contends that since he was working in his official capacity, the corporation is liable. In your opinion, can the president be held liable?

14. X is a pupil in the public grammar school. While descending the outside stairway of a fire escape she was seriously injured. Her parents bring suit against the board of education in the community. In your opinion, can the school trustees be held liable as individuals for this loss?
15. X is a teacher in a Sunday school and suffered an injury to one of his legs when a piano fell while being moved. In your opinion, is the liability of the church so remote as to free it from the possibility of damages in the event that suit is filed?
16. X operates a place of amusement and contends that he has resources to meet any liability claim. He states that most claims are minor in their nature and that even in the case of a death, which he conceives virtually impossible, he would have ample resources to meet it. Even in the case of a wealthy organization does this sound like good judgment?
17. X, a trustee of a large estate, is sued by B who is injured on one of the properties owned by the estate. In your opinion is X liable or is the estate liable?

Chapter XXVI

AUTOMOBILE INSURANCE

ORIGINALLY a Marine Coverage. According to the record, the first automobile insurance policy written in this country was issued by the Boston Insurance Company on June 2, 1902. At that time the word "automobile" was so new that it had not yet found its way into the statutes, and accordingly there was no specific authorization for the writing of automobile insurance. The policy was issued on a marine form, and the action of the company was upheld by the attorney general of Massachusetts. Interpreting the existing law, he held the insurance of automobiles to be marine insurance.

Classification of Automobiles. For the purposes of insurance, automobiles are divided into five major classes: (1) passenger, (2) commercial, (3) public, (4) dealers', and (5) miscellaneous. Rates are promulgated for each classification, and for rate-making purposes further divisions, based upon the use to which the automobile may be put, are made within those groups.

Classification of Coverage. There are five major coverages in the field of automobile insurance. With respect to protecting the insured from loss or damage to the car itself, these are (*a*) fire, (*b*) theft, and (*c*) collision. With respect to protecting the insured from loss or damage because of his legal liability growing out of ownership or use of an automobile, the coverages are (*d*) public liability, or bodily injury insurance, and (*e*) property damage insurance.

a) *Fire and Transportation.*—This coverage indemnifies the insured for direct loss or damage to his automobile caused by fire, lightning, or the perils of transportation. The body, equipment, and machinery of the car are covered, but unless specifically endorsed the policy does not cover loss or damage to robes, wearing apparel, personal effects, or extra bodies. The insurance, which follows the car, covers anywhere within the geographical limits of the United States of America, its territories or possessions, Canada or Newfoundland, and by endorsement may be further extended. While being transported in any conveyance, whether by land or water, the car is protected against such hazards as stranding, sinking, collision, or derail-

ment, including charges for salvage and general average, for which the insured is liable.

b) *Theft.*—Theft insurance is a coverage supplementary to the fire coverage and may be written only with a fire policy. The insured is protected in the event of loss of the insured car or of damage thereto caused by theft, robbery, or pilferage.

c) *Collision.*—Collision insurance reimburses the insured for damage to his own automobile sustained by reason of a collision with another car or with any other object, movable or fixed. The question as to whether upsets furnish a basis for a collision claim formerly caused much misunderstanding and controversy. To clarify the point, most policies now specifically mention loss caused by upset as within the protection of collision insurance.

d) *Public Liability.*—This coverage indemnifies the insured for loss occasioned by claims for bodily injury sustained, or alleged to have been sustained, as a result of the negligent operation of the insured automobile.

e) *Property Damage.*—This form covers the insured's legal liability for damage done accidentally by his automobile to the property of others, whether another car or other property.

Bridging the Gap. Fire and theft insurance is, as a rule, written entirely by the fire companies. The casualty companies write all of the liability business.[1] The collision business and the property damage coverages are divided between both groups. When a fire company owns a casualty company as a subsidiary, or a fire company and a casualty company are subject to common ownership or control, combination policies are issued, supplying in a single document the coverage offered by both groups. Combination policies are likewise issued by agreement between two companies which are not under common ownership or control.

It is considered desirable tc write the collision coverage in the same company writing the fire insurance. In the event a car were to be almost totally destroyed in a collision and then catch fire and become in fact a total loss, if one company covered the collision damage and another the fire damage, it would be a matter of considerable importance to determine the value of the wreckage at the inception of the fire. If one company only is interested in both claims, the de-

[1] In states permitting multiple-line underwriting, either a fire or a casualty company may write all forms of insurance except life.

termining of this value is a matter of academic interest only and does not in any way affect the amount to be paid by the insurer, since one company is to pay it all.

Fire Coverage. Besides covering private passenger cars and trucks, the automobile fire policy may be used to cover ambulances, armored cars, auto homes, fire department apparatus, hearses, motorcycles, police department automobiles, police patrol wagons, salvage corps automobiles, semitrailers, street sweepers, flushers, snowplows, tar spreaders, tractors, trailers, and industrial, railway station, or dock trucks. Automotive equipment, such as lawn mowers, steam shovels, trench diggers, and the like may not be covered under an automobile policy but are by agreement subject to the rules of the Joint Committee on Interpretation and Complaint, to which reference has been made under inland marine coverages.

The fire policy may be written to cover one or more of the following perils:

a) Fire, lightning, and transportation
b) Theft, robbery, and pilferage
c) Tornado, cyclone, windstorm, hail, earthquake, explosion, and water damage
d) Personal effects
e) Flood and rising water
f) Riot and civil commotion
g) Falling aircraft

In connection with the foregoing, insurance companies require a minimum premium on each fire policy issued. Hence, if the rate for the coverage required is less than the minimum premium, the insured in order to get full value for his expenditure ought to add additional coverages until the minimum premium has been exhausted.

Policy Forms. Three forms of automobile contracts are in general use. These forms are nonvalued, and are written (1) for a stated amount, (2) for actual value, or (3) under a comprehensive form. The first two of these forms cover named perils such as fire, tornado, and the like, while the third form is an all-risks cover.

The stated amount form insures the car for a specified sum. Since the policy is nonvalued, the stated sum represents only a limit to the company's liability in the event of loss or damage, and in no instance is it to be used as a measure of the value of the insured property.

Because of misunderstandings growing out of loss adjustments

when cars are insured for a specified sum, the actual value form has been devised. No specific amount is mentioned in the policy, and adjustment is made upon the basis of values at the time of the loss or damage. Since this is exactly the procedure followed when the car is insured for a named amount, it is felt by insurers that misunderstandings are minimized through the elimination of an association of an idea of value with the amount of insurance written. The danger of overinsurance is eliminated. The actual value policy is written to cover automobiles of the private passenger or commercial types, but is not written to cover public automobiles, such as taxicabs, buses, undertakers' cars, fleets, dealers' cars, or specialized types, such as ambulances, auto homes, police or fire department equipment, street flushers, plows, tar spreaders, and the like.

The comprehensive policy is a form of all-risk coverage. The policy was originally written only on private passenger automobiles but, in some jurisdictions, is now allowed on commercial cars. It may be written on a stated amount or an actual cash value basis in the case of private passenger cars, but under the present rules only the stated amount form is available on commercial cars. The coverage was formerly provided by endorsing the ordinary standard automobile fire form, but this has been supplanted by a special comprehensive policy form.

Automatic Insurance Period. Automobile insurance policies as now written provide automatic insurance for newly acquired automobiles for a period of thirty days. The clause as written covers two distinct situations. When the same company insures all the automobiles belonging to the insured, coverage will automatically extend to a newly acquired car, providing the same protection that the existing policies provide for cars already insured. If the insurance company does not insure all the automobiles owned by the insured, the automatic insurance clause provides insurance only for the newly acquired car when it is substituted for one already insured by the company.

The clause provides that the named insured must notify the company of the addition or change within thirty days. If notice is given the company within the thirty-day period, the insurance attaches as of date of delivery of the newly acquired automobile. If no notice is given, the insurance does not attach at all. Failure to give notice

leaves the insured in exactly the same position as if there were no automatic insurance clause in the policy.

Forms of Collision Insurance. Collision insurance is written under two forms: (1) full cover, and (2) deductible. Under the full cover form, the insurer pays the full amount of any loss or damage caused by a collision or upset. The deductible form follows the principles of deductible average found in marine insurance, and no liability rests upon the insurer until the loss exceeds a named amount, and then the amount of the liability is only so much of the loss as exceeds the deductible amount. Thus, if a policy is written under a $50 deductible form, a loss of $25 would impose no liability upon the insurer, but a loss of $700 would impose a liability of $650.

Deductible collision coverage is written in the usual instance under one of three forms, either $25 deductible, $50 deductible, or $100 deductible. It is permissible to write $150 deductible collision coverage on passenger cars and $250 deductible on both passenger and commercial cars. In the case of buses, where values run to large amounts, $500 and $1,000 deductible policies may be written.

Rates are correspondingly lessened as the deductible amount increases. The purpose of the deductible coverage is to provide insurance against heavy losses and to relieve the insurer of the cost of settling a large number of small losses which the insured himself is well able to bear. The extent to which the insured is willing to go in carrying his own losses is measured by the deductible clause of his policy.

A third form that serves as a compromise between the full coverage and the deductible form is termed the "convertible coverage." This form is written at 50 per cent of the premium required for full coverage protection. If during the policy term no claim is made under the contract, no further payment is required by the insured. Upon the occurrence of the first collision or upset that is made the basis of a claim, the insured is required to pay the balance of the full premium shown, regardless of how near the expiration date of the policy may be. If under this form an insured were required to pay $100 for full collision coverage, he might secure the same coverage by paying $50, and the other $50 when the first claim was filed. If no claim is made, then no further payment is required.

Forms of Comprehensive Coverage. The comprehensive policy is

in fact an all-risks coverage and may be written with or without collision. The policy insures against any loss of, or damage to, the automobile covered and equipment usually attached thereto. It is the broadest policy available, covering loss or damage arising not only from fire and theft, but also from such perils as (*a*) breakage of glass from any cause whatsoever; (*b*) malicious mischief to paint, upholstery, motor, tires, and the like; (*c*) windstorm, hail, tornado, cyclone, earthquake, explosion, and water damage; (*d*) riot, riot attending strike, insurrection, or civil commotion; (*e*) flood, rising waters, immersion; (*f*) damage by falling aircraft. Damage by collision is not covered unless specifically included in the contract. The policy may be written on a full-cover basis or upon a deductible form, the deduction applying to the entire policy or only to the collision feature. The exclusions from the comprehensive policy are unimportant in view of the breadth of the cover. These are:

A. (1) Loss of use; (2) depreciation; (3) robes, wearing apparel, and other personal effects.

B. (1) Wear and tear; (2) mechanical or electrical breakdowns, failures, or breakages; (3) freezing; (4) damage to tires, except when such damage is directly caused by, and resulting from, other loss or damage which is covered.

C. (1) Loss of tools or repair equipment by theft, robbery, or pilferage unless the entire automobile is stolen.

D. Loss or damage due to: (1) wrongful conversion, embezzlement, or secretion by a mortgagor, vendee, lessee, or other person in lawful possession of the insured property under a mortgage, conditional sale, lease, or other contract or agreement, whether written or verbal; (2) war, invasion, military, naval, or usurped power; (3) confiscation or authorized destruction by duly constituted governmental or civil authorities.

E. (1) While the automobile is used as a public or livery conveyance for carrying passengers for compensation; (2) while rented under contract or leased; (3) while used in any illicit or prohibited trade or transportation; (4) (as respects loss caused by collision with any other object or by upset, when such collision or upset is covered) while being operated by any person under the age limit fixed by law or in any event under the age of fourteen years; (5) while subject to any lien, mortgage, or other encumbrance not specifically described.

It will be noted in the foregoing exclusions that wrongful conversion, embezzlement, or secretion is not covered, but the exemption applies only to mortgagees or other named parties in lawful possession of the property as set forth above.

The comprehensive policy may be written with the following com-

bination of coverages: (1) full coverage as to all losses; (2) a deductible of $25, $50, or $100 applying to all losses; (3) same deductibles as above applying only to collision, with full coverage as to all other losses; (4) convertible collision coverage, with full coverage as to all other losses; (5) full coverage on all losses, with all collision losses excluded.

Fire and Theft Coverage for Dealers. Dealers' cars are defined as "automobiles owned by dealers and held for sale or used in repair service, including the dealers' equity in new automobiles consigned to the dealer, the title to which is held by others." Automobile parts, materials, or accessories kept as stock but not attached to automobiles may not be covered under a dealers' automobiles policy.

There are five plans from which an automobile dealer or the owner of a garage may select a fire and theft coverage.

1. The first plan covers dealers' automobiles by issuing separate policies for each automobile insured. The rate applying to dealers' policies is obligatory, and a special dealers' form is required. Pro rata cancellation is allowed, subject to a minimum premium of $1.00. This plan is the most satisfactory for small dealers having but few cars on hand at a time.

2. The second form requires the entry of the car to be insured in a passbook, with the issuance of a certificate on each car. The insurance becomes effective when the risk has been accepted by the company. When the car is sold or disposed of, another entry is made in the passbook, and the certificate is canceled. The premium charge is computed on a pro rata basis, with the same minimum premium as required under the first plan.

3. The third plan involves the purchase of a stated amount of insurance to cover blanket on all cars. Limits of liability on both new and secondhand automobiles must be separately stated, and the total of such limits represents the total amount insured under the policy. If the insured maintains cars at more than one location, separate limits for each location must be stated. Insurance may be added to or canceled from the policy at pro rata rates. When the risk is large enough, the insurance may be written on a monthly reporting form. This plan has the advantage of simplicity and affords the insured complete coverage at all times provided his policy limits are adequate.

4. In some territories a policy may be issued on a reporting form for a period not exceeding one year. Under this form, monthly re-

ports are required showing separately the actual cash value of cars at each location.

5. The fifth form, likewise a monthly reporting form, permits the establishment of a maximum amount of liability at each location of the insured and bases the premium on the average reported values rather than on a specific amount on each car, as in the case of the fourth form.

The different forms available for dealers are designed primarily for adjustment to different sizes and classes of operations. The coverage provided by the insuring clause relating to fire, transportation, theft, and tornado is the same in all dealers' policies and the type of property insured is the same. In addition to the usual hazards of fire, transportation, theft, and tornado, the policy may be endorsed to include such perils as earthquake, explosion, hail, riot or civil commotion, and aircraft damage. Riot and civil commotion cover may be added separately if desired, and the endorsements may or may not include malicious mischief and vandalism coverage, depending upon the needs of the insured.

The fire and transportation rates on all five of the dealers' forms are based upon the contents fire rate of the building in which the cars are stored. Under the blanket form, when there are a number of different locations, the insured may apply for an average rate.

One-Interest Collision and Conversion. These covers are useful only to dealers or finance companies. The single-interest collision indemnifies the finance companies or dealers in the event of loss by the collision of a car in which they have an interest because of a loan or unpaid balance. The owner of the car derives no benefit from the insurance and must make good his payments as agreed. If the car is not repaired by the purchaser and, because of this the dealer or the finance company suffers loss, the insurer is liable but has subrogation rights against the car owner.

Conversion cover is likewise issued to dealers and finance companies and insurers against losses resulting from the wrongful disposal of the car by the owner while there is still due an outstanding balance on the purchase price. It is a form of theft cover protecting the creditor against the wrongful act of the debtor.

Personal Effects Coverage. Robes, wearing apparel, and other personal effects are not a part of the automobile and, therefore, are not covered against loss by an automobile policy. The automobile

coverage may be extended to insure these items against the perils of fire, lightning, and transportation. When so endorsed, the policy does not cover salesmen's samples, merchandise for sale or exhibition, theatrical wardrobes, accounts, bills, currency, deeds, moneys, notes, securities, or other evidences of debt, or property specifically or otherwise insured.

The theft, robbery, or pilferage of personal effects from an automobile cannot be covered under an automobile policy. This fact is sometimes not understood and after a loss causes dissatisfaction. If the owner of a car wishes to protect his personal effects against loss by theft, he must purchase an inland marine personal effects coverage. The premium on such a policy is higher than an insured usually is willing to pay only to insure a robe, coat, or other personal effects liable to be stolen from a car.

Plate Glass Coverage. For the payment of an additional premium, the fire policy may be extended to cover loss or damage to any glass permanently attached to and forming part of the automobile insured. Glass in outside lighting apparatus and outside mirrors is excluded.

Tornado, Earthquake, and Water Damage. When endorsed on the fire policy, the perils insured against are extended to include tornado, cyclone, windstorm, hail, earthquake, explosion, and accidental and external discharge or leakage of water. This endorsement excludes damage caused by rain, snow, sleet, flood, rupture of tires, and explosion within the combustion chamber of the engine.

If protection against flood and rising waters is desired, either with or without the foregoing coverage, the policy may be extended to include loss or damage caused by the rising of navigable waters; the overflow or the breaking of the boundaries of ponds, lakes, or streams; or the accidental discharge or leakage of water from pipes, conveyors, or tanks. This endorsement does not cover damage caused by tides, whether normal or abnormal, or by the overflow of a sea wall. Damage by rain, snow, or sleet, as in the case of the tornado coverage, is excluded.

Garage Keepers' Legal Liability. Garage keepers who have in their custody cars belonging to others may insure their legal liability for loss or damage to these cars against the perils of fire, explosion, theft, and collision. In the case of collision, a deductible form is required.

The premium charged is based upon the capacity of the garage. The policy is required to stipulate the maximum number of automobiles belonging to others to be stored in the location named in the policy. Not only does this information fix the premium, but it serves to determine the company's limit of liability in any one fire, conflagration, or other catastrophe insured against.

Towing and Road Service Expense. In connection with private passenger automobiles, the fire policy may be endorsed to cover towing and repair service charges necessitated by the disablement of the automobile insured while off the premises of the insured. The endorsement limits the liability of the insurer to $10 and does not cover the cost of repair parts or replacements, gasoline, oil, or tires. The coverage is not a part of the comprehensive policy and, whenever desired, must be secured by the payment of an additional premium of $2.00 and proper endorsement made a part of the policy.

Riot and Civil Commotion. Insurance coverage is obtainable for the perils of riot, riot attending a strike, insurrection, and civil commotion. Rates are promulgated for the coverage, but under emergency or abnormal conditions the rate is usually advanced, and the premium charged is three times that required under normal conditions. In any case, a minimum charge amounting to 40 per cent of the annual premium is made.

Emergency or abnormal conditions are held to exist and warrant the higher rate when a riot, strike, or other like disturbance exists or is impending or threatened in any locality where the insured is using or intends to use the insured automobile. Malicious mischief and vandalism cover may be written with this form and is subject to a $25 deductible applying to the amount of each determined loss.

Special Combined Additional Coverage. Passenger automobiles may be insured in a single endorsement against certain miscellaneous perils such as tornado, windstorm, cyclone, earthquake, hail, explosion, water damage, or flood. This form extends to include the perils of riot, insurrection, and civil commotion and may be written either with or without malicious mischief or vandalism.

The following or a similar form is used to provide the special combined additional coverage. Under the clause, the following insurance is provided:

1. Tornado, Windstorm, Cyclone, Earthquake, Hail, Explosion and Water Damage. . . . . 2. Riot and Civil Commotion as follows: Riot, Riot Attending a

Strike, Insurrection and Civil Commotion; provided, however, that this Company shall not be liable for loss or damage (*a*) caused by military, naval or aerial forces of foreign enemies, or (*b*) confiscation or authorized destruction by duly constituted governmental or civil authorities, nor (*c*) occurring while the automobile is used in military or police service. 3. Damage by Falling Aircraft as follows: To cover the automobile described herein against direct loss or damage by the falling of an aeroplane, seaplane, or other flying machines, or by the forced landing of any such aircraft, whether out of control or not, or by falling of any part of the equipment thereof, whether the entire aircraft falls or not. It is understood and agreed that this insurance does not cover such loss or damage if sustained while the automobiles described are within the confines of any regular landing field, testing field, beach or airport landing field, or while parked within 100 yards of any such field. 4. Flood and Rising Water Damage as follows: Direct loss or damage caused by rising of navigable waters; over-flow or breaking of boundaries of ponds, lakes or streams; or accidental discharge or leakage of water from pipes, conveyors or tanks.

Under this cover, there is no liability for loss or damage caused by tides, whether normal or abnormal, or by the overflow of a sea wall. As in the case of tornado and allied coverages, there is no cover for damage by rain, snow, or sleet. This endorsement gives a broad protection for the insured automobile but not as complete as the comprehensive form and, in the circumstances, is used only if the comprehensive form is unavailable for the type of automobile to be insured.

Loss or damage caused by an airplane, seaplane, or other flying machine or by the forced landing of any such aircraft, whether out of control or not, is covered, as is loss or damage caused by the falling of any part of the equipment. The insurance does not cover such loss or damage if sustained while the insured automobile is within the confines of any regular landing field or airport or parked within 100 yards of any such field.

Fire and Theft Rates. The fixing of an equitable rate for fire and theft insurance involves appraising a large number of hazards which may exist not only in the construction of the car itself, but also in the uses to which it is put and the community in which it is maintained and operated. Rates are determined by a rate-making conference on the basis of data submitted by member companies.

On the basis of the insured car exposure in a given community and the experience developed in that community, the entire country is divided for the purposes of automobile insurance into territories. It follows, therefore, that the fire and theft premiums on an identical

car will differ on the basis alone of the community in which it is maintained and operated.

The next element for consideration is the age of the car. If a stated value policy is written, cars are classified as either "new" or "old." Automobiles purchased new not more than eighteen months previous to the attachment of the insurance are considered to be "new," and all others are rated "old." There are four age groups applicable to actual value and comprehensive coverages and to fire and transportation, theft and tornado insurance.[2] As the age of the car increases the rate advances. Since the amount of insurance to be written on an old car decreases with age, insureds frequently anticipate a reduction in premium. Such a reduction is frequently offset by the increase in rate.

Collision Rates. For collision coverage, the territory in which the car will customarily operate must first be ascertained. The age and cost of the car are then the two important factors in determining the premium. Separate rate tables are promulgated for commercial and passenger automobiles. In the case of commercial cars there are but two groups, old and new. In the case of private passenger cars there are four premium age groups.[3]

The cost of full coverage collision insurance has been so high that this insurance is held by many to be prohibitive. As a matter of fact, however, if the insured is willing to bear the small losses himself, the cost of the protection is sharply reduced. The deductible feature affords protection against large losses.

When collision insurance is desired for a greater number of automobiles than there are drivers, the rules provide that a policy may be issued naming such operators and specifying all the cars to be covered. The premium is computed by charging the full collision premium on the number of highest rated automobiles equal to the number of operators; and on the remainder of the automobiles, 25 per cent of the full premium is charged. Thus, an owner of a business using eight cars, but operating but four at a time and hiring but four drivers,

[2] Age groups provided in the manual are as follows: (1) automobiles purchased new not more than six months prior to the date insurance attaches; (2) automobiles purchased new more than six months but not more than eighteen months prior to the date insurance attaches; (3) automobiles purchased new more than eighteen months but not more than thirty months prior to the date insurance attaches; (4) automobiles purchased new more than thirty months prior to the date insurance attaches.

[3] Premium age groups for collision are the same as those used for fire and theft rates.

would pay a full premium on four cars and 25 per cent of the premium on the other four.

When there are five or more commercial or public cars under a single ownership, a policy based upon an estimate of the average number of operators may be issued. The advance premium charged is the total annual collision premiums for the number of highest rated automobiles equal to the estimated number of operators to be employed, plus 25 per cent of the premium applying to the remaining automobiles owned by the insured. The premium thus computed is adjusted at the end of the policy term by determining through monthly reports the average number of operators employed during the year. The premium is then computed, using the rates in effect at the inception of the policy, but substituting the average number of operators for the estimated number.

The Policy. In addition to the fundamental doctrines of insurance practice centering around the principles of indemnity, insurable interest, subrogation, fraud, inception and termination of the coverage, and the like, which remain the same in the automobile policy as in other contracts insuring property, features of the contract present new questions because of the nature of the property insured.

When an automobile has become damaged, an insured frequently feels that it cannot be replaced in a manner to satisfy him or restored to a condition reasonably approximating that before the loss. In such a case, he feels it not at all unreasonable to ask from the insurance carrier the full value of the car, leaving the salvage to the company. Under the policy, the insured has no right of abandonment, nor has the company any obligation to settle on such a basis. Regardless of the lack of any right on the part of the insured to abandon, the company has the right to take any part or all of the salvage at the appraised value. The measure of the insured's loss represents the difference between the value of the insured property before the loss and the value of the salvage. It does not matter that salvage is beyond repair, nor is it necessary that the amount of loss be sufficient to repair the damage.[4]

[4] In the case of a used car, the cost of repairing after a loss is often several times the value of the car before the loss. For example, a car valued at $100 before a fire and valued at $20 for junk after the fire represents a loss of $80, and the cost of replacing the car in its original condition has no bearing on the amount of the loss. On new cars, the amount of the damage and the cost of repair are often the same.

Automobile losses occur frequently in distant or isolated places. Negligence on the part of the insured to exercise reasonable care in preserving the damaged property and protecting it from further loss may result in loss or damage not collectible under his contract. The policy undertakes to reimburse the insured for all reasonable expense incurred in protecting and preserving any salvage, and the insured is obligated to take all reasonable steps to this end. In the case of theft losses, immediate notice should be communicated to the public authorities. The insured is not obligated to offer any reward for the return of his property, and if he does so without the specific authorization or direction of the insurer, such a disbursement is not collectible under the policy.

In the case of disagreement between the insured and the company as to the amount of the loss or damage, the policy provides for an appraisal, following the procedure described for the standard fire policy. Proof of loss is required within sixty days after the happening of the loss, and if court action is necessary, suit must be brought within twelve months after the loss is determined. The company may wait sixty days after an award before making payment on a claim, but also, if there are no statutory regulations to the contrary, it may make payment at any time within that period.

The policy expressly excludes liability for loss or damage to the automobile while in possession of a carrier or bailee for hire under a contract making the insurance available to the bailee or carrier. To the end that the insured will be protected, the company agrees to advance to the insured by way of a loan, money equivalent to his loss or damage. This money is to be repaid to the insurance company to the extent of the net amount collected by, or for, the account of the insured from the carrier or bailee after deducting the cost and expense of collection. This procedure prevents railroads or steamship lines, otherwise liable, from taking advantage of a shipper's insurance.

The policy is without effect and void if the insured is other than the sole owner of the car insured, unless such other interest is consented to by endorsement or is otherwise made a part of the policy. Any encumbrance, lien, or mortgage will void the policy, as will any change of interest of the insured through sale or otherwise. The policy is likewise terminated by an assignment before a loss without the consent of the company.

FOR REVIEW

1. May a fire and theft policy be written to cover a trailer used for living quarters, or is this automatically covered by the policy insuring the automobile used to haul it?
2. A carries a $50 deductible collision policy together with glass insurance. The car skids and overturns on the road without colliding with another object. The total damage to the car is $120, of which $15 is accounted for by damage to the glass. Under the policies, what can be collected?
3. Mrs. Y on her way home from a shopping trip stops to make a short call upon a friend. She leaves several packages in her parked car. Would the theft of these packages be covered under an automobile theft policy?
4. Would the situation be different if the articles stolen were: (*a*) robe, (*b*) tools?
5. The automobile of A is stolen. In addition to the value of the car, A claims reimbursement for loss of use. May he collect?
6. If loss of use grows out of a collision, will the collision policy reimburse the insured during the period repairs are being made?
7. B collides with another automobile with but slight damage. B carries collision insurance and finds the only injury to his car to be a blow-out. Is the damage covered?
8. X, a dealer, pays $1,000 for his cars f.o.b. factory. The cost of placing each car in his salesroom is $80. The automobile sells for $1,400. In the event of complete destruction by fire, how much may be collected by the dealer on each car?
9. In the foregoing case, if a car had been sold but not removed and insured by the purchaser, presuming the same fire and circumstances, for how much is the insurer liable?
10. The Blank Company carries a dealer's fire and theft policy. Which of the following losses are covered: (*a*) cars burned in transit; (*b*) car stolen from an open storage lot; (*c*) car stolen from an unlocked and unattended garage; (*d*) car damaged in open lot through exposure to neighboring fire?
11. When a pro rata distribution clause appears in the automobile dealer's fire and theft policy, how does this clause operate to fix a limit to the company's liability in the event of the loss of a car valued at $3,000, assuming $100,000 insurance covering $25,000 in location A and $75,000 in location B? The destroyed car was in location B when destroyed. Inventory at location B at time of loss $75,000, at location A $75,000.

Chapter XXVII

AUTOMOBILE LIABILITY INSURANCE

AUTOMOBILE Liability Covers. Bodily injury liability, frequently referred to as "public liability insurance," and property damage liability, to which the term "property damage insurance" is sometimes applied, undertakes to pay, on behalf of the insured, sums which he in turn is obligated to pay because of legal liability by reason of the injury of others or damage to the property of others. Bodily injury liability insurance is written entirely by the casualty companies, and although the fire and marine companies may write property damage, the bulk of this business is handled by the casualty insurers. Personal injury and property damage coverages seem logically to form one group, just as fire, theft, and collision seem to form another. Collision insurance may be written with the personal injury coverage, but that is not the usual procedure. Multiple line underwriting has not yet become sufficiently established to greatly modify the practice of dividing the business as here indicated. As time goes by, the trend will probably break down the line of demarcation now established.

Moral Obligations Coverage. The automobile liability coverages under the insuring agreements of the policies, obligate the insurance company to pay, on behalf of the insured, all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law. Insureds have frequently been instrumental in causing injuries to persons under circumstances in which negligence would be imputed. In the circumstances, the liability insurance company is obligated to make no payment to the insured party. This situation has become frequently a source of annoyance and embarrassment to insureds who have felt themselves morally obligated to make payments to passengers riding with them who have been injured, the result of an automobile accident. The situation has been the occasion of temptation to collusion. The injured passenger, claiming negligence on the part of the insured, has frequently attempted to collect for injuries sustained; and the insured because of the friendly relationship between himself and his passenger, has hesitated to vigorously defend the action in the interests of the company. Conscien-

tious and honest insureds have carefully followed the terms of the policy. Others have admitted negligence so that their passengers could collect. Entirely aside from the considerations of negligence, there are many who feel a moral obligation to make payment to passengers injured in an automobile that they own or operate. To people in this classification, the strict legal liability policy is something less than the complete type of coverage they require.

The situation has given rise to a new form of coverage which is in fact attached to the liability policy but is not in any sense a liability coverage. This form, known as "first aid" or "medical payments coverage" undertakes to pay, subject to policy conditions, for medical and surgical relief, the outgrowth of an accident involving the insured car, without regard to the legal liability of the insured to make such payments.

The Marx Plan. While automobile bodily injury and property damage insurance is written on a liability basis, it may be noted at this point that there has been a considerable movement in the direction of placing automobile accidents on a compensation basis. Such a plan would assume that any person taking an automobile on the highways would be absolutely liable for injuries to the public and could not avail himself of any defenses to relieve himself from the obligation of compensating the injured parties. On the other hand, a schedule would be set up providing for the payment for injuries.[1]

The plan has its appeal to those who contend that, frequently, injured parties are unable to get witnesses to prove liability on the part of the car owner. Delays in the law courts postpone settlements an unduly long period of time. This may particularly be the case where the automobile owner is without insurance. The plan has never been put into effect in any jurisdiction but has been carefully studied and has attracted wide interest on the part of those interested in automobile liability insurance. The idea was first suggested as a means for settling personal injury claims against railroads.[2] Mr. Robert S. Marx adapted the idea to automobile insurance, and the plan proposed by him has been identified with his name.[3] The idea

[1] This follows the plan now in effect for workmen's compensation insurance. It will presently be noticed that under workmen's compensation coverages liability is not a prerequisite for the payment of compensation to injured parties.

[2] Balantine, A. A., "A Compensation Plan for Railway Accident Claims," 29 Harvard Law Rev. 705.

[3] Marx, R. S., "Compulsory Automobile Insurance," 11 A.B.A.J. 731 (1927); "Compulsory Automobile Insurance," 1 U. of Cinn. Law Rev. 445 (1927); "Compensation for

in recent years, with the enactment of compulsory insurance and financial responsibility laws, has tended to wane.[4] There are many, however, who still believe the idea to have merit.

The Standard Automobile Liability Policy. As the result of work carried on by committees representing the National Bureau of Casualty and Surety Underwriters, the American Mutual Alliance, the Insurance Commissioner's Association, and the American Bar Association, standard policy provisions were adopted and are now used by companies holding membership in either the National Bureau of Casualty and Surety Underwriters or the American Mutual Alliance. The new standard provisions were made effective by most companies in January, 1936. The greater part of the automobile business is now written upon policies making use of the standard provisions. In some states the law requires the addition of other provisions than those to be found in the standard policy, and in one state different standard policy requirements have been enacted by the legislature; but the coverage furnished by the mandatory form is essentially the same as that to be found in policies using standard provisions.

When the standard policy first became effective in 1936, automobile insurance underwriters were fearful lest the policy check developments in coverage or, if developments continued, make necessary a policy burdened with confusing endorsements. Fortunately, this has not been the case. The policy has been revised several times, and, in one instance, two revisions were made within less than a year. Recent revisions have made no drastic changes in the form but have tended to clarify doubtful points or to enlarge the scope of coverage when this seemed to be advisable.

Combination Policies. If a fire company organizes a casualty company as a subsidiary, or a casualty company owns or controls a fire company, or an agreement is made between two such independent companies, a combination policy may be issued in which fire, theft, collision, personal injury, property damage, and such of the supplemental coverages as may be desired, are all covered. A combination policy is, as a matter of fact, two policies in a single document, in which the fire company assumes the fire, theft, collision, and allied coverages while the liability company assumes the personal injury

Motor Accidents," *New Republic,* September 21, 1927, p. 112; "Wholesale Compensation Insurance," 25 Col. L. Rev. 164 (1925).

[4] See "Report to Committee to Study Compensation for Automobile Accidents" made to the Columbia University Council for Research in the Social Sciences, 1932.

and property damage risk. The insured need not concern himself with this technicality of two companies, and for him the combination policy contains in a single document all the coverages required by him.

One of the most recent revisions of the standard policy provisions is designed to harmonize the provisions which are common to both physical damage and liability policies, thereby making possible the issuance of combination policies with uniform provisions. These revisions became effective July 1, 1941, and their use became mandatory by companies holding membership in either the National Automobile Underwriters Association or the American Mutual Alliance on January 1, 1942.

In those states where multiple-line underwriting is permitted, fire insurance companies will be able to write all forms of automobile liability insurance, and the casualty companies will be able to write fire, theft, collision and allied lines. The necessity for combination policies will no longer be present. The trend is in the direction of multiple line underwriting but for some time, because of established practices and customs, as well as the fact that not all states permit multiple line underwriting, combination policies will continue to be written.

Policy Limits. The limits of a liability policy represent the maximum amounts which the company obligates itself to pay in the event that a claim arises under the policy. The policy limits of the automobile property damage and personal injury liability insurance and the value of the car insured have no relationship, one with the other. The amount of insurance to be carried is based rather upon the probable amount of a judgment the insured may be called upon to pay.

Automobile rates are quoted on the basis of standard limits. Standard limits provide coverage for the insured's liability for injury to the property of others up to $5,000; and in the case of personal injury, standard limits provide the same protection up to $5,000 for bodily injuries to, or death of, any one person; and, subject to the same limit for each person, the company's liability is limited to $10,000 for bodily injuries or death involving more than one person in a single accident.

Such personal injury limits are frequently referred to as the "five and ten limits" and are explained erroneously as covering the insured's liability for injury to a single person up to $5,000 with a limit

of $10,000 in a single accident. If this statement were correct, an injury involving one claim of $7,000 and another of $2,000 in a single accident would bring the total of the claims under the $10,000 limit. This is not the case. The lower limit of $5,000 is set as the maximum payable to a single person, and the upper limit of $10,000 is *subject to the same limit* for each person. Therefore, in the instance mentioned, the total of the claims amounts to $9,000, but the liability under the $7,000 claim is limited to $5,000. The $2,000 claim is payable in full. The company's liability for claims amounting to $9,000 is $5,000 plus $2,000. The other $2,000 the insured must bear himself.

Excess Limits. Because judgments and costs growing out of automobile claims frequently run to high figures, the standard limits of five and ten in the case of personal injury liability are held by many to be inadequate. The danger of doing damage to personal property in excess of $5,000, while possible, is considered to be more remote. To meet the requirements of the individual insured, rates are provided for higher limits in both the liability and the property damage coverages.

TABLE 4

	Lower Limits													
Upper Limits	5	7.5	10	15	20	25	30	40	50	100	150	200	250	300
10	% 100	% 107	% 110	%										
15	104	111	113	116	%									
20	106	113	115	118	120	%								
25	107	114	116	120	121	122	%							
30	108	115	117	121	122	123	124							
35	109	116	118	122	123	124	125	%						
40	110	117	119	123	124	125	126	127						
45	111	118	120	124	125	126	127	128	%					
50	112	119	121	125	126	127	128	129	130					
70	113	120	122	126	127	128	129	130	131					
100	114	121	123	127	128	129	130	131	132	% 133	% 135			
150	115	122	124	128	129	130	131	132	133	134	136	% 137	% 139	% 141
200	116	123	125	129	130	131	132	133	134	135	137	138		
250	117	124	126	130	131	132	133	134	135	136	138	139	140	
300	118	125	127	131	132	133	134	135	136	137	139	140	141	

Since in the majority of cases claims can be satisfied out of the amount set by the standard limits, and only the occasional or disastrous claim will run into large amounts, the insurance company can and does write the excess limits at an additional premium very

much less than that charged for the standard limits. Table 4 indicates the percentage of premium charged in addition to the premium for standard limits in the case of a private passenger car. The lower limit represents the insurance company's limit of liability for injury to a single person, and the upper limit represents the carrier's limit of liability in a single accident.

Declarations. The first page of the standard policy contains a section known as the "Declarations." In this section is to be found: (*a*) name of insured, place of use, and occupation; (*b*) the policy period; (*c*) specific coverages; (*d*) description of the automobile; (*e*) nature of use; (*f*) ownership; (*g*) cancellation record.

Name of Insured, Use, and Occupation.—For the purposes of underwriting, it is, of course, essential that the insurance company know for whom it is writing the insurance. It is quite possible that the owner of an automobile has a criminal record, a record for reckless driving, or an otherwise unfavorable reputation and, for this reason, is unacceptable to the insurance company because of the moral hazard involved. If such a person could buy automobile insurance in the name of another, obviously insurance companies would be at a serious disadvantage in their underwriting. The place of use is likewise important in that upon this information territorial rates are based. Insurance in metropolitan areas is considerably higher than in small urban communities, and rates for rural areas are still less. For the policyholder to declare that the automobile is used primarily in a rural area when, as a matter of fact, it is used most of the time in a metropolitan area would amount to a false statement and would serve as grounds for voiding the insurance. The insurer is likewise interested in knowing the occupation and business of the insured. This gives some information as to the nature of the use of the insured vehicle and also some information concerning the moral hazard.

Policy Period.—The purpose of this clause is readily apparent. It indicates the time when the insurance becomes effective and the time when the policy will, in the normal course, expire. If an insurance policy is to be effective on the day that it is ordered, it is the custom to write into the policy the day and the hour that the coverage commences. In the absence of specific mention of time, all policies become effective at 12:01 A.M., and expire at 12:01 A.M., on the termination date.

Specific Coverages.—The policy usually provides a schedule set-

ting forth the specific coverages that may be written, and it is provided under the declarations that the insurance afforded is only with respect to such coverages as are indicated by a special premium charge or charges set opposite each hazard. The limit of the company's liability against each coverage is set forth.

Description of Automobile.—The purpose of this section of the declarations is to identify the automobile for which insurance is to be provided. Not only is it important that the insurance company have a sufficiently accurate description of the automobile so that it may be clearly identified in the event of a loss, but it is also important since the rates are predicated upon the type of car, its age, and use.

Nature of Use.—Automobile rates are predicated upon the use to be made of the insured car, and for this reason it is required that its use be stated in the declarations. For the purposes of underwriting, automobiles are classified either as pleasure and business or as commercial. The term "pleasure and business" is defined in the policy as "personal pleasure and family use, including business calls." The term "commercial" is defined as "transportation or delivery and the loading and unloading of goods or merchandise in direct connection with the insured's business occupation as expressed in the declarations." The commercial classification permits occasional use of the car for personal pleasure and family use. Both classifications are further subdivided for rating purposes.

Ownership.—The insurance company has a right to know for whom the insurance is to be written. If there is more than one owner, the risk may prove unattractive because of the reputation or previous loss experience of one of the owners. On this account the company has a right to full information as a basis for its underwriting. The clause requiring full information as to ownership precludes the possibility of an undesirable risk conveying a part-interest in an automobile to another and seeking the protection of insurance by obtaining coverage in the name of a second party when he himself could not obtain it as a named insured. If the policy is encumbered, this fact must be made known to the insurance company, and the nature of the encumbrance appears at this point in the declarations. To fail to notify the insurance company concerning an encumbrance is equivalent to a misstatement in connection with this declaration.

Previous Cancellation Record.—The insurer wishes to know something of the past record of prospective insureds. When an in-

surance policy has been canceled there is usually evidence of some reason that will have a bearing upon the underwriting of the risk. It does not follow that, because one insurance company has canceled a policy, the applicant is forever barred from obtaining future insurance. It is a fact, however, that the applicant must give a clear and comprehensive statement of the facts if insurance has ever been declined or canceled. Cancellation to be reported in connection with the declarations must have been effected by an insurance company against the wishes of the policyholder. If a policyholder, himself, submits a policy for cancellation or if the coverage is terminated with the agreement of the insured, failure to report this is not regarded as a breach of warranty.

Insuring Agreements. The insurance agreements of the standard policy set forth and carefully define the coverages available and the obligations assumed by the company. The policy sets forth the obligations under bodily injury liability as follows:

> To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages, including damages for care and loss of services, because of bodily injury, including death at any time resulting therefrom, sustained by any person or persons, caused by accident and arising out of the ownership, maintenance or use of the automobile.

In the case of property damage liability, the following appears:

> To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages, because of injury to or destruction of property, including the loss of use thereof, caused by accident and arising out of the ownership, maintenance or use of the automobile.

It has already been noticed that many people feel under obligation to make payment to persons injured while riding with them in an automobile and, because the automobile bodily injury policy may not cover every injury, insurance companies have worked out a plan whereby the automobile liability policy covers the payment of reasonable and necessary medical, surgical, ambulance, hospital, and professional nursing expenses to persons injured by the insured automobile provided the automobile is used with permission of the named insured. In the event of death, the policy covers reasonable funeral expenses.

The medical payments coverage appears in the policy in the following form, and the coverage is optional with the insured:

To pay to or for each person who sustains bodily injury, caused by accident, while in or upon, entering or alighting from (1) the automobile classified as "pleasure and business" if the injury arises out of the use thereof by or with the permission of the named Insured or (2) any other private passenger automobile with respect to the use of which insurance is afforded under Insuring Agreement V [Use of Other Automobiles] of this policy, if the injury arises out of the use thereof and results from (a) the operation of said automobile by the named Insured or spouse or by a private chauffeur or domestic servant of either or (b) the occupancy of said automobile by the named Insured or spouse, the reasonable expense of necessary medical, surgical, ambulance, hospital and professional nursing services and, in the event of death resulting from such injury, the reasonable funeral expense, all incurred within one year from the date of accident. The insurance afforded with respect to such other automobiles shall be excess insurance over any other valid and collectible medical payments insurance applicable thereto.

Under this coverage the company pays reasonable medical expenses, subject to the limits per person, indicated in the policy. Reasonable funeral expenses are paid if death occurs within a year from the date of the accident. The policy may be written to include the named insured if this coverage is desired. The important feature to recognize in connection with the medical payments cover is the fact that while made a part of the liability policy it is not, in fact, a liability coverage. The endorsement provides for payment regardless of the legal liability of the insured. The more usual limit is $250 or $500 per person, although higher limits are obtainable when required.

In addition to the foregoing, the company assumes a responsibility with respect to the defense of suits against the insured, the payment of premiums on bonds determined to be necessary in connection with the defense of a claim, the payment of expenses incurred in connection with the claim, and, finally, the reimbursement of the insured for sums disbursed or obligations incurred in connection with furnishing first aid for an injured person. These obligations are set forth in the policy in the following clause:

It is further agreed that as respects insurance afforded by this policy under coverages A and B[5] the company shall:

a) Defend in his name and behalf any suit against the insured alleging such

[5] Coverage A is bodily injury liability, and coverage B is property damage liability. Medical payments is coverage C.

injury or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the company;

b) Pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without any obligation to apply for or furnish such bonds, all costs taxed against the insured in any such suit, all expenses incurred by the company, all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the company's liability thereon, and expense incurred by the insured, in the event of bodily injury, for such immediate medical and surgical relief to others as shall be imperative at the time of accident;

c) Reimburse the insured for all reasonable expenses, other than loss of earnings, incurred at the company's request.

The company agrees to pay the amounts incurred under this insuring agreement, except settlements of claims and suits, in addition to the applicable limit of liability for this policy.

Under the terms of the so-called "defense clause," in addition to the obligations assumed by the company to defend the insured, there is also reserved to the company the right to make investigations and effect a settlement under terms deemed expedient to the company. This affords the company an important right but carries with it a corresponding obligation. It gives the insurance company the absolute right and authority to make any settlement it cares to effect within the policy limits. After a case has been turned over to the insurance company for adjustment, the insured has, as a matter of right, no control whatever over the details of the adjustment unless the company evidences an intention to settle for an amount in excess of the policy limits. If the insured is to be asked to contribute to such an adjustment, his consent, of course, is necessary. On the other hand, if the insured takes matters into his own hands and proceeds to effect an adjustment with the claimant, the insurance company is under no obligation to make payment in accordance with these terms or to reimburse the insured for any payment he makes.

The question sometimes presents itself as to responsibility of the company if it fails to accept an offer of settlement within the policy limits and elects to let the case go to trial, with a resulting judgment in excess of the policy limits. It has sometimes been contended that in such an instance the insurance company should be obligated to pay the full amount of the judgment. This is not the rule, and if the

company refuses to settle and elects to try the case, the policy limits are thereby not increased. However, if the insurance company is guilty of bad faith, fraud, or negligence and, as a result, the insured is called upon to contribute to the loss, the case is different, and the insured has grounds for action against the insurance company.

Exclusions. Exclusions in the automobile policy have been subject to considerable change from time to time.

This policy does not apply:

a) [Under any of the coverages,] while the automobile is used as a public or livery conveyance, unless such use is specifically declared and described in this policy and premium charged therefor;

b) [Under any of the coverages,] to liability assumed by the insured under any contract or agreement;

c) [Under coverages A and B,] while the automobile is used for the towing of any trailer owned or hired by the named insured and not covered by like insurance in the company; or while any trailer covered by this policy is used with any automobile owned or hired by the named insured and not covered by like insurance in the company;

d) [Under coverages A and C,] to bodily injury to or death of any employee of the insured while engaged in the employment, other than domestic, of the insured, or while engaged in the operation, maintenance or repair of the automobile;

e) Under coverage A, to any obligation for which the insured or any company as his insurer may be held liable under any workmen's compensation law;

f) Under coverage B, to injury or to destruction of property owned by, rented to, in charge of or transported by the insured;

g) Under coverage C, to bodily injury to or death of (1) any person to or for whom benefits are payable under any workmen's compensation law because of such injury or death, or (2) the named insured if stated as excluded in the declarations, but if the named insured is two or more individuals, the named insured, for the purposes of this exclusion, shall be the individual or individuals in whose name the automobile is registered.

Policy Benefits. The undertaking to protect the insured against "loss and/or expense resulting from claims" introduces protective features other than the actual payments of claims.

First, the insurer undertakes the investigation necessary to secure all important data to safeguard the insured's interests. This is frequently not a simple matter, and the experience of the company's representatives enables them to render important service. This is particularly so if the claim is fraudulent or groundless.

The insured is protected against expenses involved in defending

the case, such as attorney's fees, court costs, appeal bonds, interest on judgments appealed, and other like expenses. In the event the car is attached, the expense of furnishing a release of attachment bond is covered by the policy.

The entire defense of the claim and the details of settlement are taken over by the company, and the expense items are covered in excess of the policy limits. Thus, an insured with $5,000/$10,000 limits is protected in a case involving a judgment in a single claim of $5,600, with $1,000 expenses, for $6,000. The policy limit of $5,000 is paid on the claim, and the expense item is paid in addition.

Additional Interests. The liability and property damage policy covering private passenger and commercial cars extends the coverage of the policy to other interests than the named insured. The clause may not always be equally broad in all policies, and in policies covering garages, school buses, taxicabs, and public cars of any type, it does not appear at all.

The clause affording this extension of coverage is referred to as the "omnibus clause." This extension is contingent upon the car's being used with the permission of the named insured and for no other purpose than permitted by the terms of the policy.

The national standard automobile policy makes a distinction between the "named insured," who is the policyholder, and the "insured," which term includes, not only the named insured, but also any person while using the automobile and any person or organization legally responsible for its use, provided the declared and actual use of the automobile is "pleasure and business" or "commercial." The omnibus clause now found in the standard policy reads as follows:

> The unqualified word "insured" wherever used in coverages A and B and in other parts of this policy, when applicable to such coverages, includes the named insured and, except where specifically stated to the contrary, also includes any person while using the automobile and any person or organization legally responsible for the use thereof, provided the actual use of the automobile is with the permission of the named insured. The insurance with respect to any person or organization other than the named insured does not apply:
>
> *a*) To injury to or death of any person who is a named insured;
>
> *b*) With respect to the automobile while used with any trailer not covered by like insurance in the company; or with respect to any trailer covered by this policy while used with any automobile not covered by like insurance in the company;

c) To any person or organization, or to any agent or employee thereof, operating an automobile repair shop, public garage, sales agency, service station or public parking place, with respect to any accident arising out of the operation thereof;

d) To any employee with respect to injury to or death of another employee of the same employer injured in the course of such employment in an accident arising out of the maintenance or use of the automobile in the business of such employer.

It is to be noted that the clause applies only in the case of private passenger and commercial cars. Policies covering garages, school buses, taxicabs, and public cars of any type do not provide this extension of coverage.

The reason for the four exceptions is apparent. The first exception eliminates the possibility of double insurance. This would apply when the person using the insured car was himself covered under his own liability policy with a "drive other car" endorsement, or was otherwise protected. The second exemption eliminates the possibility of the named insured becoming a claimant, as the result of an accident in which he is himself involved, with his own policy providing the protection. For example, if the named insured should be riding in his own car, though not himself driving, he could not make a claim for personal injury against the driver as a result of an accident and expect his own liability policy to cover the claim. The third exclusion eliminates certain types of risks which the insurance companies cover under a garage policy. Without this exclusion the customers would supply the insurance for garages and like risks, and losses would ultimately be reflected in the customers' rates. The fourth exclusion eliminates the possibility of claims that are normally covered by workmen's compensation policies. There are cases on record where a workman injured by an automobile accident collected under the workmen's compensation policy and then sued the operator of the car and collected through the operation of the omnibus clause of his employer's insurance. Insurance companies contemplate that the risk of injury to employees in the course of their employment shall be covered by the workmen's compensation policy. The fourth exclusion eliminates the compensation hazard, and at the same time, where compensation insurance is carried, eliminates the possibility of employees making claims as members of the public against fellow employees with the expectation that the employer's automobile coverage would furnish the indemnity.

The requirement that the car be used with the permission of the named insured raises the question as to the nature of the permission required. While, under the older forms of automobile insurance, permission might be given by any adult member of the insured's household, under the terms of the standard policy permission must be granted expressly by the named insured, either directly or through a duly authorized agent. When the car is continually used with the permission of the named insured, as in the case of wife or other members of the family, express permission is not required in each instance the car is used. The continued use of the car by another than the named insured raises the presumption of permission.

Passenger Carrying Risk. The automobile liability policy does not cover when the insured car is used as a public livery conveyance unless such use is specifically declared and described in the policy and a premium charged therefor. Formerly, the exclusion included the wording "or for carrying persons for a consideration." Since the term "consideration" might include anything of detriment to the promisor or benefit to the promisee, it was apparent that a consideration could be something other than a cash payment. The term "consideration" was held to be far too broad to express the intent of the framers of the policy, and in later revisions of the contract the word "charge" was substituted. To carry passengers for a charge permitted the assumption that an agreement had been entered into between the owner of the car and the passenger and that the passenger was definitely making payment for his transportation. When there is simply a friendly relationship such as contributing to the expense of a trip and the contribution does not exceed actual expenses and is not definitely planned to cover such items as wear and tear and all incidentals, the payment is not regarded as a charge.

The exclusion remained unchanged and the policy did not cover while the automobile was used for carrying persons for a charge until August 7, 1941. The gasoline shortage on the Atlantic seaboard made necessary a program of conservation. As part of the program, automobile owners were urged to share transportation facilities with others. To permit private passenger car owners to co-operate with the Defense Petroleum Co-ordinator in the "share-your-car" campaign without increasing their insurance premiums or voiding their policy contracts, underwriting rules were modified. The word "charge" does not now appear in the policy. This action by the in-

surance companies did not have the effect of permitting private automobile owners to use their cars as public livery conveyances.[6] As has always been the case, to cover a public livery conveyance the use must be specifically declared and described, and the required premium charged. Since the 1942 policy, the reference to passenger carrying, except public livery, has been entirely eliminated.

Guest Hazard. A guest riding in an automobile occupies quite a different position from that of a passenger who pays a consideration. There is no contractual relationship, but the guest is rather in the position of an invitee or licensee, depending upon the circumstances under which the passenger is carried. The legal liability of the insured for injury to guests is covered under the policy.

States, in some instances, foreseeing an opportunity for collusion and false claims, have specific legislation bearing upon the question, going so far in certain instances as to prohibit the recovery of guests except when it can be shown by the claimant that the operator of the car was grossly negligent, deliberately or willfully brought about the injury, or otherwise acted in utter disregard of the safety of his passengers.

Claims made by one member of a family against another are regarded with suspicion by insurance carriers as involving possible collusion. As a matter of public policy, some states by legislative enactment have set limits in the matter of actions by persons within certain degrees of relationship. In the cases in which a member of a family, relative, or other guest makes a false or unreasonable claim, the insured must bear in mind his responsibilities and obligations to the insurer. Any proof of collusion, fraud, or false swearing on the part of the insured in connection with the settlement of a claim is sufficient grounds to void the policy.

The medical payments coverage to a large degree eliminates the guest hazard problem. It may present itself, however, in the case of a serious injury where the medical payments coverage proves inadequate to satisfy the injured parties or where medical payments coverage is entirely lacking.

Bankruptcy or Insolvency Clause. Liability policies as formerly written permitted the insurer, when the insured because of insolvency or bankruptcy could not meet the judgment, to refuse to pay the claim. A judgment in such cases might remain outstanding

[6] See (*a*) under Exclusions.

against the insured for many years or actually precipitate him into bankruptcy.

Policies now are written to provide that if the insured or other persons entitled to benefit under the policy are insolvent or bankrupt, the company shall not be released from the payment of damages for injuries or loss occasioned during the life of the policy. The policy now provides that in the event an execution against the insured is returned unsatisfied by a claimant because the insured is insolvent or bankrupt, the claimant may proceed directly against the company for the amount of the judgment, but not in an amount in excess of the policy limits.

Assumed Liability. Since the liability policy undertakes to cover the legal liability of the insured, the company is liable to reimburse the insured for only such payments as the law requires him to make. Any agreement or contract on the part of the insured to make a settlement for injuries caused is not binding upon the insurer.

The insured is obligated to co-operate in every way within reason in facilitating the investigation and disposition of claims and suits. He is specifically prohibited from voluntarily assuming any liability, incurring any expense or settling any claim except at his own cost without the previously obtained written consent of the company. An exception is made only in the case of personal injury to another, when the insured may provide at the company's expense such immediate surgical relief as is imperative at the time of the accident. This exexception does not extend to the assumption of any liability whatever for hospital bills or other attendant expenses.

Other-Car Exposure. Until recently, the automobile liability policy covered the insured only while driving the car named in the policy. In its new form, the automobile bodily injury and property damage policy issued to individuals on private passenger cars provides a limited drive-other-car coverage for a husband or wife if liability claims are brought against either as the outgrowth of driving a hired or borrowed car. The coverage extends to the use of private passenger automobiles that they may occasionally hire or borrow, and, in addition, there is provided nonownership liability for cars operated on behalf of the insured and his spouse by chauffeurs and domestic servants in their employ.

The coverage is also made to extend to the temporary use of a substitute automobile. If the insured car is withdrawn from normal

use because of its breakdown, repair, servicing, loss or destruction, the liability coverage extends to another automobile that the assured may borrow and use temporarily as a substitute for the automobile out of commission. The policy provides that this extension of coverage does not extend to the owner of the substitute automobile or any of his employees. It is designed purely as a service for the company's own insured so that there will not be a temporary period of exposure while the insured car is out of commission for repairs or while the insured is negotiating for a new car.

A broad form drive-other-car coverage is available at an additional premium charge, and this coverage is needed when the insured frequently drives hired cars or when the insured uses a car furnished for his regular use. This policy is also required when evidence of financial ability to pay is demanded of the insured as a condition precedent to a license under financial responsibility laws.

Financial Responsibility Laws. Because of the difference in the financial responsibility laws in the different jurisdictions, the insurance companies, to provide adequate protection, have now incorporated a clause in their policies designed to meet the requirements of any state. The following clause now appears in the standard policy:

> Such insurance as is afforded by this policy for bodily injury liability or property damage liability shall comply with the provisions of the motor vehicle financial responsibility law of any state or province which shall be applicable with respect to any such liability arising out of the ownership, maintenance or use of the automobile during the policy period, to the extent of the coverage and limits of liability required by such laws, but in no event in excess of the limits of liability stated in this policy. The Insured agrees to reimburse the Company for any payment made by the Company which it would not have been obligated to make under the terms of this policy except for the agreement contained in this paragraph.

This clause has the effect of covering a policyholder when, because of the operation of an automobile, he comes within the statutory requirements of any state or province. The clause does not provide for any coverage not already included in the policy, nor does it operate to extend the policy limits.

Suspension. Automobile liability and property damage coverages, and collision insurance as well, may be suspended with a pro rata return of premium if the automobile is placed out of use for a

period of at least sixty consecutive days. The rule was originally effective only in territories where the winter season made it necessary or desirable that the automobile be taken out of service. The rule no longer applies to winter months, and in any case where the insured has occasion to lay up his automobile for sixty days or more he is entitled to the premium credit.

Under the plan, when the company is notified, coverage is terminated under the suspension endorsement and does not again become effective until notice to reinstate is received from the insured by the company or its agent. If the insurance in not reinstated, insurance is regarded as having been canceled as of the date of the suspending endorsement and a short rate return premium is allowed.

Notice of Accident. Under the terms of this clause, the insured is required to give written notice "as soon as practicable." The clause sets forth the requirements as to notice and also sets up requirements in the event of a suit. The clause provides:

> 1. Notice of Accident (Coverages A, B and C). When an accident occurs written notice shall be given by or on behalf of the insured to the company or any of its authorized agents as soon as practicable. Such notice shall contain particulars sufficient to identify the insured and also reasonably obtainable information respecting the time, place and circumstances of the accident, the names and addresses of the injured and of available witnesses.

The requirement as to particulars is, in the ordinary course, easily met by the use of forms provided by the insurance companies for filing notice. The use of these forms has the effect of simplifying the matter of the report and clearly indicates to the insured the nature of the information required. Lacking a form, the insured should secure every detail that he feels will be of any help to the company in the course of adjusting any claim that may develop.

If a claim for damages is made or the insured is made defendant in a suit, the insured is obligated to forward to the company every demand, summons, notice, or other process as soon as he receives it or service has been made. This having been done, it is the duty of the company to defend the suit in the name of the insured or other interested party or to adjust the claim, bearing the costs thereof in either case.

The obligation of giving prompt notice is important. The company has a right to know the full nature of any accident that may give rise to a claim in order that it may effect a settlement or compro-

mise on advantageous terms. The importance of a prompt notice is brought out in the following excerpt from a court decision:

> The insurer was deprived of an opportunity to make a prompt investigation while the facts were fresh in the minds of the parties and witnesses, and before physical marks and effects of the accident had been obliterated. As to certain breaches of condition, it may more readily be shown whether prejudice had resulted therefrom. But respondent argues with convincing force herein that the lapse of time which removes the opportunity for prompt investigation, also destroys the possibility of showing prejudice arising from delayed inquiry. Where witnesses are interviewed after lapse of time, during which they either may have forgotten the facts, or been approached solely by representatives of the injured party, it virtually becomes impossible to learn what facts, favorable to defendant, could not have been ascertained through prompt inquiry. We are impelled to the conclusion that prejudice must be presumed in such situations.[7]

Notice given by or in behalf of the insured to any agent within the state where the accident occurs, with sufficient particulars to identify the insured, meets the requirements of notice to the company. Delay in giving notice follows the same rule noted in connection with other types of policies. Delay is excused if it can be shown that notice was given as soon as reasonably possible.

Assistance and Co-operation of Insured. This clause requires that the insured shall, upon the company's request, attend hearings and trials and assist in effecting a settlement. The clause also provides that the insured shall not, except at his own cost, voluntarily make any payment or assume any obligation other than for immediate medical and surgical relief to others that is imperative at the time of the accident. If the insured fails to co-operate in such a way that his action is material to the adjustment of the loss, this constitutes a violation of policy conditions. The policyholder is not obligated to participate in any fraudulent action as part of a defense. He must, however, give a frank and comprehensive statement of the circumstances attendant upon the accident and must do nothing deliberately that would constitute co-operation with the claimant to the end that an unreasonable claim be presented.

Action against the Company. This clause provides that before any action may be taken by the insured against the company he must have complied with all the conditions of the contract. A third party to the contract, that is, the claimant, is given the right of action against the insurance company, but only after the amount of the insured's

[7] *Purefoy* v. *Pacific Auto. Indemnity Exchange*, 53 Calif. 2, sec. 155 (1936).

obligation to pay has been determined either by judgment after trial or by written agreement of the insured, the claimant, and the company. As the standard policy was originally written, there was a time limit of two years from the date of judgment or settlement against the insured, within which suit must be brought against the company. This has now been changed, and the state statute of limitations in the jurisdiction applies. This change brings the policy in line with actual conditions because, as a matter of fact, state statutes generally supersede policy limitations. The clause specifically provides that the company may not be joined in suit as codefendant against the insured to determine the insured's liability.

Fleet Liability Plan. For the purposes of liability rate making, five or more automobiles owned by one insured under one direct operating management constitute a fleet. Discounts from the manual rate are based upon the size of the fleet, the discount increasing with the number of car increases. The discount is based on the theory that when a single concern operates a large number of cars, a percentage of them will be out of operation part of the time for repairs or other reasons.

If there is any possibility that hired cars will be used during the policy term, the hired-car liability hazard can be covered by extending the fleet plan policy on owned cars by endorsement to cover all cars and trailers hired by the insured. Careful insureds frequently incorporate the hired car endorsement into the coverage, even though they do not customarily hire cars. By paying the minimum premium charge they are protected if, in the event of an emergency, a car is hired and the matter of insurance overlooked.

Deductible Liability and Property Damage. Fleets of five or more automobiles are eligible for liability and property damage insurance on a deductible basis. The plan is usually more attractive to owners of large fleets willing to assume small claims themselves. Bodily injury deductible insurance is written with a deductible figure ranging from $250 upward, depending upon the requirements of the insured, and in some cases the amount is several thousand dollars. The deductible feature is written in two ways. It may be made to apply to each individual claim or to all claims arising out of any one accident. On property damage coverage the deductible amounts are usually lower, standard coverages being offered with a deduction of $25, $50, and $100 per accident.

The deductible feature applies only to the loss portion of the claim and not to the expenses of investigation and settlement. The insurance company, through its adjusters, handles all claims and settles them in full, charging the deductible amount against a deposit made for that purpose by the insured.

Nonownership Liability. This form of insurance, sometimes inaccurately referred to as automobile contingent liability, undertakes to indemnify the named insured for his legal liability for bodily injuries or property damage arising out of the use or operation of automobiles not owned by him. The need for the coverage grows out of the rule that the relationship between employees driving individually owned automobiles and their employers is that of master and servant, or principal and agent. In writing his coverage employees are classified into one of two classes. Employees who are known to use individually owned cars when on the business of the employer are class 1 employees. All other employees are class 2 employees; their status is unknown, they may or may not use their cars for company business.

In writing this insurance, no information concerning the type of automobile used by the employees is necessary. Territorial designations, as in other forms of automobile liability insurance, are followed, and rates are quoted flat for each class of employee.

Joint Schedule Policies. Insureds with numerous employees may protect the nonownership exposure, as an alternative to the blanket nonownership policy, by a joint schedule policy. The joint schedule plan is attractive in that it insures, not only the employer, but the employee as well; whereas the straight nonownership coverage protects the employer only.

The policy is written by specifically insuring employer and employee interest under a schedule on all cars coming within the class 1 nonownership category. A supplementary nonownership policy is then written covering class 2 employees only. The policy may be endorsed to provide a thirty-day automatic coverage for the employer in the event that employees not on the schedule change their status and commence regularly to use their cars in connection with their employer's business. Hired or borrowed cars may be covered either as to the employer's interest alone or as to the interest of both employer and employee.

Risks Certified under Financial Responsibility Laws. When, be-

cause of the operation of a financial responsibility law, an insured is required to file a certificate of insurance with the state authorities before a license is issued, the insurance companies customarily make a careful investigation of the circumstances making necessary the filing of the certificate. The rate for issuing a policy in such a case is increased in accordance with an established schedule of surcharges.

Garage Liability and Property Damage. To meet the needs of automobile dealers, garages, and service stations, a special liability policy has been devised, which is, in fact, a combination of an automobile liability and property damage policy, covering the operation of automobiles and a general liability policy covering the hazards due to the maintenance of the premises and the operation of the business. The terms and conditions of the automobile feature of the policy are in the main the same as noted under the usual liability coverage. The revised standard garage liability policy affords broad protection to officers and partners. There is now an additional interests clause which provides that the "insured" includes not only the named insured but also partners or executive officers active in the business. Coverage protecting any interest in the use of any of the automobiles covered under the policy may be added by endorsement for an additional premium. This extension applies only to cars owned by or in the custody of the garage. Automobiles personally owned by these individuals are not covered.

The general liability feature of the policy covers the insured against claims for damage caused by the operation and maintenance of a garage or sales agency. The insurance of the "premises hazard" is designed to cover the legal liability of the insured growing out of accidents common to a garage, such as explosions due to the presence of gas fumes, the use of acetylene and the like, as well as injuries caused by slipping on grease, stairs, sidewalks, or improperly lighted areas. Elevators are excluded from protection under this policy, since they are insurable separately. Losses originating because of unusual alterations or repairs are excluded and should be covered by a contractor's liability form. Finally, acts of employees who, because of their youth, are illegally employed are excluded.

The property damage feature of the policy covers the insured's legal liability for loss or damage to the property of others and excludes property owned, rented, or in charge of the insured or his employees. Protection for excluded property is obtainable on a $100 deductible

basis for the payment of an additional premium. Property carried in or upon cars is not covered, but is insurable under the inland marine truck contents coverages. Likewise, damage caused by the explosion of a boiler or other part of a power or heating plant, normally covered by boiler insurance, is excluded, as is damage caused by engine breakage or the disruption of a flywheel or turbine, insurable under power-plant policies.

The premium is computed on a pay roll basis. Rates per $100 of pay roll are promulgated for each territory, and at the beginning of the policy term the annual pay roll is estimated and an advance premium computed. Under the terms of the policy, the insured is obligated to keep an accurate record of the pay roll. The remuneration of managers, directors, and other executives actively engaged in the business, as well as salesmen, must be included up to but not in excess of $2,000 per year. The actual compensation of all others is included. At the end of the policy term, a pay roll audit is made and the advance premium adjusted.

Under the policy, coverage is excluded on cars rented without drivers, on taxicabs, omnibuses, sight-seeing automobiles, school buses, and cars used in transporting property for others. Such cars should be specifically insured. The operation of livery cars is likewise not covered, but when the livery operations are but a minor part of the business the coverage may be included by endorsement. The coverage protects the operation or use of private type automobiles carrying passengers for hire and subject to call only from the premises of the insured. The premium for this coverage is computed on the basis of gross receipts, special rates applying to the livery receipts. If livery operation is the principal business of the insured and he maintains a garage to service his own cars as an incident to the livery business, this form of coverage for the livery cars is not permissible.

Rating Territory. Public liability and property damage rates are dependent first upon a territorial designation. The rate that applies is ordinarily the rate for the manual territory in which the automobile is principally garaged and used. When an automobile is principally garaged in one territory and principally used in another territory, the rate for the higher of the two territories is used. In the case of salesmen and others whose duties require them to make use of garages in a number of rating territories, if it is impossible to assign any one

rating territory as the place of principal use and garaging, the rating territory of the residential address of the operator is used.

The method of rating within the classification of the more common types of automobile risks—(*a*) private passenger, (*b*) commercial, and (*c*) public—is presently to be noticed.

Private Passenger Automobile Rates. A "private passenger automobile" is defined as a motor vehicle of the private passenger type unaltered, used for pleasure or business purposes. The manual further includes in this classification "a motor vehicle of the private passenger type altered by the attachment of a small box or a motor vehicle of the pick-up body or delivery-sedan type used to transport tools or materials or to carry samples but not used for wholesale or retail delivery."

For rating purposes, private passenger cars are divided into three groups, consideration being given in the classification to the price, weight, power, and control equipment of the car. Added to these factors is the experience of the make and model of the automobile based upon data relating to accident experience. Letters W, X, and Y, respectively, are assigned to the groups, and a set of rates is promulgated for each group in the different territories.

In addition to the foregoing classifications, the most recent rating system for private passenger automobiles is the so-called "use plan." This plan takes into consideration, in addition to the classification of the automobile, the factors of use, mileage, number and age of drivers, as well as the individual experience of the operator. Private passenger automobiles are divided into three classes known as class A, class A-1, and class B. Automobiles in class A are those not used in connection with the business of the insured, though he may use the car in going to and from his place of business. Automobiles of farmers and clergymen are automatically included in this class unless they may be classified in class A-1. Class A-1 is the same as class A except that the car must not have been operated over 7,500 miles during the past year, and the estimated operation for the policy year must be not over 7,500 miles. Operators of the car may not be less than twenty-five years of age. All other cars fall into class B.

Commercial Automobile Rates. A commercial automobile is designated as a motor vehicle of the truck type used for the transportation or delivery of goods or merchandise or for other business pur-

poses; also as a motor vehicle of the passenger type that has been altered or as a motor vehicle of the pick-up body or delivery-sedan type used for wholesale or retail delivery.

For rating purposes, commercial automobiles are classified in accordance with the size of the vehicle and the business classification of the insured. Formerly automobiles were rated on the basis of the advertised load capacity, but this has been found to be unsatisfactory —particularly so, since recently a number of manufacturers have discontinued supplying this data. In rating commercial cars on the basis of size, use is made of the corresponding information shown on the state registration certificate for the car. Since some states register cars on a gross vehicle weight basis, others use the net vehicle weight or chassis weight, while others again use the actual load capacity for which the truck is used, the actual tables promulgated for determining the rate differ with the different states. Notwithstanding the different registration bases that are used, commercial cars in all states are treated uniformly. To accomplish this a table of size values geared to the registration basis for each state has been established. The rating tables in the manuals differ in the different states because of this difference in the registration base but actually the end result is to divide cars into two classifications. In one group are to be found all trucks with a load capacity not over 9,500 pounds, or in terms of gross vehicle weight not over 19,500 pounds. The second classification applies to all other commercial cars and to tank trucks with a capacity over 1,000 gallons, as well as tractors used to haul commercial trailers.

Automobile underwriters have found that the loss experience on commercial cars used for the same purpose remains reasonably uniform except on the unusually large automobiles. The large size automobiles have definitely evidenced a higher loss ratio than that produced by the smaller cars.

Another rating factor is to be found in the distance of operation from the home base. Commercial cars involving long-distance operations have evidenced that these operations are definitely more hazardous than those confined to a local territory. A surcharge is placed on all risks which are customarily operated more than fifty miles from the place where they are garaged. A careful study is now being made of trucks engaged in long-distance operations with a view to accumulating an adequate volume of reliable statistics to supply an

adequate measure of the difference in the hazard between local and long-distance hauling. The surcharge can be modified one way or another on the basis of the statistical evidence that is developed.

Finally, differentials in the rate are effected for the territory in which the car is operated, and the business classification into which the car falls as a result of its use. A commercial classification table shows the classification rate to be charged for each car according to the use of the car or the business in which it is used. All commercial automobiles fall into one of six different classifications and different sets of rates are promulgated for each class. Territorial tables are promulgated designed to gear the rates to the experience attributable to the territory in which the vehicles operate.

Public Automobiles. Automobiles of any type used to carry passengers for hire are classified for rate making purposes as public automobiles. The class is further divided into (*a*) private livery, (*b*) public livery, (*c*) taxicabs, and (*d*) buses. The distinction between a private and public livery lies in the use of the car. A private livery automobile is an automobile of the private passenger type seating not over nine persons, excluding the operator, and rented only from a garage with a chauffeur in the employ of the insured in charge of operating the car. The car may be used for social functions, shopping trips, tours, and the like. A public livery automobile fits the same description but may operate from a stand, station, or other public place and is hired with a chauffeur by the hour, day, trip, or mile.

Because public automobile rates are high and because there is no risk when the car is not in operation, a system of rating has been devised on an earnings basis or on a mileage basis. Taxis and livery automobiles of both classes pay on a rate based upon each $100 of gross receipts. Taxi rates are quoted to apply to each mile the taxi is in actual operation.

Governmental Functions and Personal Liability. In connection with the operation of automobiles in towns and municipalities, the question of personal liability attaching to trustees and others in authority is a serious one. The question is not at all settled, but with the development of new activities on the part of municipalities there is a tendency on the part of the courts to regard many of them as outside of governmental functions. Where so considered, it is the tendency to hold the municipality or district to the same degree of liability as attaches to private enterprise. In passing upon a school bus accident

the Supreme Court of Washington held the bus to be a common carrier and hence bound to exercise the high degree of care applying to such carriers.

Whether in cases of this sort any liability attaches personally to the trustees or the school board is unsettled. Because of this uncertainty, automobile liability policies are written to cover municipalities, boards, or districts and without extra charge may be endorsed to cover the legal liability of individual board members, bus owners when hired buses are used, and their drivers. High limits are recommended for school bus insurance. A minimum of $50,000 is considered essential, and in view of the small cost for higher limits a coverage of $250,000 on an ordinary bus is not out of line with reason.

While it is accepted that a municipality cannot be sued for damages growing out of accidents caused by fire apparatus, the Supreme Court of Vermont has held that the fireman driving the apparatus does not enjoy the same exemption and must answer for damages when he is at fault. In other cases in which the state could not be held, state officials have been held individually liable.

Territorial Extent of Coverage. The automobile liability policy, as written without extension by endorsement, provides insurance within the continental limits of the United States of America, Canada, and Newfoundland. At the option of the company, the coverage may be extended upon request. The willingness of the company to extend the coverage is influenced by local laws, experience, and its facilities to service the policy.

In the course of a year, hundreds of cars are used by Americans in their travels abroad. Liability coverage must be provided, not only to meet the needs of the insured, but also to meet any requirement set by the laws of the country where the car is to be used. The important insurance carriers are familiar with these requirements, and when a car is taken abroad, they usually cancel existing coverages and provide a new policy to meet the insured's needs in the countries in which he intends to travel.

Comprehensive Automobile Liability Policy. In line with the development of comprehensive insurance covers, the National Bureau of Casualty and Surety Underwriters and the American Mutual Alliance have drawn up a policy form, known as the "comprehensive automobile liability policy." This policy differs from those covering specific exposures in that it covers all the liability of the insured

from the maintenance or use of any automobile irrespective of the kind of car or by whom it is owned. The insuring clause provides insurance against:

> The liability imposed upon him by law or damages, including damages for care and loss of services, because of bodily injury, including death at any time resulting therefrom, sustained by any person or persons, caused by accident and arising out of the ownership, maintenance or the use of any automobile.

The comprehensive liability policy makes a particular appeal to the individual or concern which has a number of automobile exposures. To insure separately the drive-other-car hazard, the garage risk, the nonownership risk, hired car risk, and other like exposures with the attendant possibility of overlapping coverages in some instances and failure to complete coverages in others has given rise to a serious problem that the comprehensive policy admirably solves. In addition to covering all known automobile exposures, it covers as well any loss that may develop from an unknown and unforeseen exposure.

FOR REVIEW

1. B was employed in a chain store as an attendant at the soda fountain. He was transferred to another part of the city to a better position. He phoned a friend and notified him of the vacancy created by his transfer and volunteered to drive him after working hours to interview his former manager. On the way, the car met with an accident and the passenger was seriously injured. In your opinion, has this man a claim against the chain store company?
2. Trucks owned by a large construction company carry a liability insurance policy in which it is warranted that none of the insured automobiles will be used to tow or propel a trailer. The contractor frequently uses his trucks to tow a concrete mixer. Does this void the policy?
3. X leaves his automobile at a public garage for repairs. The garage offers to loan X a car for his use during the period repairs are being effected. While driving the car belonging to the garage, X seriously injures a pedestrian. He carries $10/20,000 liability policy. In the event of a $12,000 verdict, how much would his liability policy pay?
4. Y borrows an automobile from X. X sends his driver with instructions to take orders from Y. In the event of an accident what, if any, is the responsibility of Y?
5. What is the automatic coverage granted under the automobile public liability policy?
6. Smith is the attorney and adjuster for the A, B & C Railroad Company. While on a pleasure trip he learned of an accident in the vicinity where he

was traveling and undertook to adjust it. He had no instructions from the company to do this. He became involved in an automobile accident, and suit was filed against the railroad company. Is the railroad company liable?

7. A, B, C, and D are partners in a firm operating an amusement park. The Z liability company insures the firm against loss arising out of automobile accidents for which the firm is liable. To what extent will this policy protect the individual members of the firm?
8. X carries a $5/10,000 policy on his automobile. His car collides with another, and a child is injured. An offer of settlement is made in the sum of $4,500. The insured requests the company to adjust on this basis, but the company, feeling the amount to be excessive, decides to carry the case to court. A verdict is rendered in favor of the claimant of $17,000. What is the liability of the insurance company?
9. If a suit has been tried and the defendant found to be liable for damages within the limits of the policy, what is the position of the liability insurance company if it insists upon an appeal, and the higher court renders a verdict in excess of the policy limits?
10. When a judgment is rendered against an insured carrying a liability policy and the judgment is in excess of the limits of the policy, how is the case handled from this point?
11. X company is insured under a garage liability policy. It occasionally sends out a car to carry passengers for hire. As a result of a collision, a passenger suffers a serious injury. Is the insured protected under the garage liability policy?
12. The garage liability policy extends to cover cars owned by the firm. Does this include cars owned personally by members of the firm?
13. A banking firm having thirty employees decides to effect insurance, for those members of its staff driving automobiles, by paying a proportion of the premium on the individual policy of each insured and having the bank named in the policy as an additional insured. To what extent is the bank covered?
14. The Bank Production Company is a partnership owned by A and B. Does the automobile liability policy written in the name of the partnership cover the interest of the partners?
15. The owners of a sales and service station carry a dealer's liability policy. A woman entering the premises slips where some grease has been spilled and, through negligence, not removed. Does the policy cover? Would the answer be the same if the woman were injured by snow falling from the roof?
16. B a garage keeper contends that he is not the insurer of automobiles left in his charge to be cared for and, therefore, is not responsible if a car so left is damaged. Explain his position.
17. An automobile left with X, a garage keeper, is stolen. X claims that he exercised every reasonable care and is, therefore, not liable. What is your opinion?
18. X has a public liability automobile policy and has been brought into court because of the violation of a traffic law. He understands that his policy will provide payment for a bail bond if he is arrested following an accident, but

raises the question as to whether it covers in the event of a traffic violation. Can you answer?

19. X has a liability policy covering his personally owned automobile. The coverage provides limited drive-other-car insurance. He is driving an automobile belonging to his brother and as a result of an accident has been arrested. He realizes his liability policy will protect him against liability claims while driving a car he does not own, but does not know whether it extends to provide a bail bond in the same circumstances. What is the situation?

Chapter XXVIII

AVIATION INSURANCE

A SPECIALIZED Line. We have today adequate insurance facilities for handling aviation risks of every description. Standardized policies have been developed and rates promulgated for all the usual coverages. Premium volume from all sources is small; and because in most coverages there is always a potential total loss hazard, individual companies are reluctant to assume occasional lines. The business has, therefore, become highly specialized. Groups have been formed by interested companies to write the business, and the underwriting is placed in the hands of underwriting agents or managers who are specialists in aviation coverages.

Engineering Service. One of the outstanding achievements in the field of aviation underwriting is a country-wide inspection and engineering service. The facilities made available to the policyholder whereby he may avail himself of the services of experts exprienced in improving hazards and avoiding accidents prove to be an attractive feature of the coverage. The insured is interested in being indemnified in the event of loss, but more especially is he interested in preventing a possible loss. The service rendered is to a degree paralleled by that rendered for many years by the steam boiler inspectors employed by boiler insurance companies.

Classification of Risks. Planes are classified in accordance with the use to which they are put, as (*a*) private business and pleasure, and (*b*) commercial. The first classification applies to individuals or corporations not engaged in commercial aviation who own or use aircraft for pleasure or business. This classification extends to the transporting of guests without charge, executives, and salesmen, and includes other uses in connection with business or pleasure.

The commercial classification extends to the use of aircraft operated by a flying school, sales agencies, taxi, or other like operations of a fixed base operator. Since the rates for a coverage are less if the policy excludes student instruction or the renting of aircraft to others, the commercial classification is sometimes subdivided into (*a*) commercial, excluding instruction, and (*b*) commercial, including instruction. Dealers or distributors fall into a special-risks group as do

a number of risks involving unusual conditions, such, for example, as flying boats, multi-engine aircraft, manufacturing risks, scheduled airline operations, and flying clubs.

In connection with aviation insurance, distinction is made between ground coverages and flying coverages. The ground coverages provide indemnity only if the loss occurs while the aircraft is on the ground and not in motion. The flying coverages include damage to the machine arising out of flight and liability coverages. For the purposes of insurance, an aircraft is deemed as not in flight under all circumstances, except during the period of time commencing with the actual take-off run and continuing thereafter until it has safely completed its landing run. Or, stated differently, the policy defines the term "flight" as "the period from the time the aircraft moves forward in taking off or in attempting to take off for air transit, while in the air, and until the aircraft completes its landing run after contact with the land or water." The distinction is a very important one, frequently developing borderline cases giving rise to doubt as to the exact status of the coverage. Even if both ground and flying coverages are included in a single policy, if under flight coverages the insured is covered under a participating or deductible form and under the ground coverages the insured has full protection, the amount of the liability of the company will differ depending upon whether the accident happened just prior to actual take-off, immediately after landing, or during flight.

Only aircraft licensed by the United States Department of Commerce are regarded by insurers as risks eligible for insurance. Since the skill and experience of the pilot is said to constitute 90 per cent of the company's risk in underwriting aviation insurance, particular emphasis is centered upon the qualifications and character of the pilots who will fly the insured planes.

The Coverages Written. At first glance the aviation coverages seem to parallel the automobile coverages. In a degree this is true, but the risk in aviation insurance differs in so many ways from that in automobile insurance that coverages have been developed varying widely from the automobile policies in many important features.

While there are a number of forms of coverage available, depending upon the hazards to be insured, there are but two forms of policy. The first of these, the aircraft hull policy, is written by fire insurance companies and covers the risks of damage to the insured aircraft. The

second form is the aircraft liability policy and is written by the casualty companies to cover the various liability hazards.

The hull policy provides insurance against direct loss or damage from the perils defined on the schedule of coverages attached to the policy. Policies are written either on a "named perils" or an "all-risks" basis. When written on a named-perils basis, the policy may be arranged to include any or all of the following coverages: (1) fire, (2) crash insurance, (3) land damage, (4) windstorm, (5) mooring, and (6) theft. When written on an all-risks basis, the policy provides complete hull coverage both on the ground and in the air and includes such perils as crash damage, tornado, cyclone, windstorm, earthquake, flood, hail, sleet, snow, collapse of the hangar or building in which the plane is stored, denting, marring, or scratching while in the care or custody of a hangar keeper, and every other conceivable risk which may damage the plane. The exceptions are few. They are: wear and tear, deterioration or conversion by a person in possession of the aircraft, or loss due to mechanical breakage or structural failure is not covered. While the policy does not cover loss due to mechanical breakage or structural failure, damage by collision or fire which results from such breakage or failure is covered. The all-risks form may, however, be written covering all risks with the exception of specifically excluded perils. For example, a policy can be written "all risks excluding crash" or "all risks excluding crash but including fire in air except following crash." Various other exclusions may be incorporated in the all-risks policy depending upon the requirements of the insured.

In contrast to automobile direct damage policies, aviation hull covers run to large sums. Even the lower priced privately-owned planes run to values considerably in excess of low-priced automobiles, but in the case of the larger risks the difference is wide and policies involving hundreds of thousands of dollars on a single plane are not at all unusual.[1]

Liability coverages are written to cover public and passenger liability, property damage, and liability policies required in connection with civilian pilot training programs. In addition, airport

[1] One of the biggest aviation policies ever written covered "full risk" on the test flights of the Douglas B-19 bomber. About a hundred insurance companies were reported to have participated in a pool providing insurance in the amount of $1,000,000. The premium was said to be $82,000, and the term of the policy was indefinite but covered during test flights. The bomber is said to have cost over $3,500,000.

liability and property damage policies are available, as well as hangar keeper's liability covers.

In addition to the foregoing coverage, the casualty companies issue policies covering the risk of personal accident, as well as workmen's compensation or employers' liability coverages. Cargo insurance is, strictly speaking, not classed as an aviation line, but is written by fire companies in their inland marine departments. The hangar fire risk, windstorm hazard, and theft losses come within the scope of ground coverages. Accidental damage or "crash insurance," public liability, passenger liability, and property damage form the important coverages of the flying classification.

Fire Insurance. The fire policy is essentially a ground coverage, though it may be extended to cover under all circumstances or to cover under circumstances specified in the policy. When written as a ground cover, the insured plane is covered against fire from any cause, as well as from explosion and lightning, but not against fire and collision resulting from crash or collision while in flight. The policy covers, as well, damage sustained to the insured plane as the outgrowth of any accident to the conveyance in or upon which the aircraft, when properly dismantled and prepared for shipment, is being transported by land or by water.

The fire peril may be written in connection with any or all of the other named perils, and, of course, this peril is covered in the all-risks policies. However, a named perils policy is never written for one or more perils without including the fire peril. Fire coverage is basic and must be included in all-hull contracts.

The fire hazard in aviation is particularly great not only because of risk inherent in the construction of the plane itself, but also because of the conditions usual to the hangars in which planes are stored. Causes of plane fires, exclusive of hangar hazards, include (*a*) the backfiring of engines, (*b*) short circuits in electrical wiring or other electrical equipment, and (*c*) the development of static electricity in filling or emptying tanks. Hangar hazards are to be found in the accumulation of gasoline fumes in the enclosed structure, in the use of blow torches and welding machines, in carelessness with matches by employees or visitors, and in carelessness with oily rags, grease, or waste.

All airplane fire rates are "loaded" because of the conflagration hazard. It has been demonstrated by past experience that a hangar

fire, once started, burns furiously and develops a terrific heat. The fire spreads rapidly, often because of gasoline fumes or exploding gasoline tanks, and the chances of saving planes stored in the building are negligible.

Theft Insurance. Airplanes are rarely stolen, and for this reason theft rates are comparatively low. On occasions when planes have been stolen, they have usually been badly damaged, if not entirely wrecked. The pilferage hazard is much greater, and accessories and valuable instruments are not infrequently stolen. This is particularly the case when a plane has been forced to land in unfrequented territory.

The aviation theft policy covers theft, robbery, or pilferage, including damage done by thieves. The coverage excludes liability for theft, robbery, or pilferage committed by any person in the insured's household, or in the insured's service or employment, as well as wrongful conversion, embezzlement, or secretion by a mortgagee, vendee, or lessee.

Windstorm Insurance. The tornado, cyclone, and windstorm contract is strictly a ground coverage and, therefore, covers no loss whatsoever occasioned by flight or descent. Flight damage from tornado or windstorm is covered under the accidental damage form. The insured machine is covered while in the hangar or in the open. Fire damage is excluded except when fire is the aftermath of the collapse or fall of the building housing the insured plane when the fall is caused by a windstorm. The coverage includes damage caused by hail, storm, rain, sleet, snow, earthquake, flood, or water.

Windstorm insurance is considered an essential coverage for airplanes. In the case of automobiles, the risk is ordinarily very slight; in the case of airplanes, losses are very common. Because of the construction of airplanes, a seemingly harmless breeze may lift the plane and carry it against some object, causing serious damage. Cases are recorded where planes, after being pegged down, tore the pegs from the ground, were carried into the air on a strong wind 1,000 feet or more, and when finally hurled to the ground were completely wrecked.

In addition to the hazard due to the construction of the plane, the hangar further contributes to the risk. An airplane safely housed in its hangar may be seriously damaged by collapse of the hangar or by its partial destruction.

Mooring Damage. This provides insurance against perils of the sea while the insured craft is moored. Seaplanes, amphibians, and flying boats of every class are required on occasion to be moored. While not in use, such craft are usually hauled out of the water and securely housed. Nevertheless, because of the necessity from time to time of mooring, insurance is provided to cover the risk incurred.

The principal hazards are the danger of being struck or run down by another craft and sunk, of being torn away from moorings by a wind, of being overturned and submerged. Losses occasioned by mooring mishaps can run to very substantial amounts.

Stationary Land Damage. The danger to an airplane of becoming involved in the mishap of another plane or of being otherwise injured while stationary is covered under this form. The insured plane is covered against loss or damage other than damage caused by windstorm while the aircraft is on land but not in flight. Losses caused by collision with another aircraft, vehicle, building, or other object are covered, as are losses by breakage, denting, marring, or scratching while the insured aircraft is in the care and custody of a hangar keeper, repair or service organization for storage, service, repair, overhaul, or reconstruction and provided the aircraft at the time of loss or damage is not under the control of the insured, his agent, or employee and the loss or damage is not caused by any act or omission on the part of the insured, his agent, or employee. The insurance is usually written to provide that the first $50 of every land damage claim is to be borne by the insured.

Accidental Damage Insurance. This is primarily a coverage against the perils of the air. It is commonly referred to as "crash insurance," and the protection afforded is similar to collision coverage in automobile insurance. The policy covers loss or damage that may occur to the insured aircraft by collision with the ground or with another object arising during flight or any attempt thereat. Loss or damage caused by fire and lightning is excluded, except that the risk of fire while the machine is under its own power, including fire following crash, is covered. Mechanical breakdown is not covered; but if mechanical breakage or breakdown is the cause of an accident, the resulting damage is covered. The coverage extends to losses due to stranding or sinking or to towing following a forced landing on the water. Salvage charges, if any, are covered. If the aircraft is missing and unreported for sixty days after commencing flight, the plane is

presumed to have been lost from one of the perils covered under crash damage.

The rates for this coverage are high. It is the practice, in the interest of a moderate rate to provide that the insured ship bear a part of any loss. Policies are written to follow one of two practices. In some instances the policy calls for a deductible of either 5 per cent or 10 per cent of the amount of the insurance; in other instances a percentage ranging from 20 per cent to 33⅓ per cent applies to the amount of the loss. Hence, a plane valued at $50,000 and insured against accidental damage at the rate of 8 per cent would require an annual premium of $4,000. A crash resulting in a $6,000 damage, with a 10 per cent deductible feature, makes the insurer liable for the difference between the deductible amount of 10 per cent of the value of the plane and the amount of the loss, or $1,000. Of course, had the plane been completely demolished, the company's loss would have been $45,000.

The Hull Contract. Hull risks use the same policy form regardless of the perils covered. The insuring clause indicates that in consideration of the premium stated and subject to the stipulations and general conditions included in the policy insurance is granted, in respect to the aircraft listed in the schedule of particulars, against direct loss or damage from the perils defined in the schedule of coverage. The insuring clause further states that the policy itself embodies all agreements between the insurer and the insured. This is in contrast to the policy that previously prevailed by which the application was made a part of the contract. The schedule is attached in the form of a rider and indicates the perils against which the insurance is written. Immediately following the schedule of coverages is a schedule of particulars which describes the make, model of aircraft, and other pertinent data concerning the insured craft, describes the use to which the insured craft is to be put, and lists the pilots who may fly the craft.

The policy provides that the insurer will pay the insured value of the plane in the event of total loss subject to whatever deductions are provided in the schedule of coverage. The rates for hull insurance are based on the assumption that the aircraft is insured for 100 per cent of value. No coinsurance clause actually appears in the contract, but the practice of requiring insurance 100 per cent to value is in line with that followed generally in inland marine business. In

the case of all hull policies total losses are subject to depreciation at pro rata of 20 per cent per year for new aircraft and 15 per cent for used aircraft. New aircraft are held to be planes less than three months old at the time the insurance attaches.

In the case of partial loss adjustment is made on the following basis:

a) If repairs are made by other than the Insured, the cost to repair the damaged property with material of like kind and quality, plus reasonable transportation charges [as defined in the policy], less deductions, if any.

b) If repairs are made by the Insured, the total of the following items, less deductions, if any:

1. Actual cost of material or parts of like kind and quality;
2. Actual wages paid for labor at current rates with no additional for overtime;
3. Fifty per cent of Item 2 in lieu of all overhead including supervisory services;
4. Reasonable transportation charges as herein defined.

In the case of partial loss, the policy provides that any payment computed on any basis indicated above shall not exceed the amount due if the loss payable were a total loss. It is further provided that if the amount payable for partial loss is equal the amount payable as a total loss, any salvage value remaining shall inure to the benefit of the insurer. As in the case of other similar contracts, however, the policy provides that there shall be no abandonment to the insurer without its consent. Reasonable transportation charges to which reference is made are defined in the policy as the cost of the least expensive method of transporting new or damaged parts, or the aircraft itself, to the place of repair and the return of the repaired aircraft to the place of accident or home airport, whichever is nearer.

There are but few exclusions in the policy, and these may be summarized as follows: (*a*) unlawful use; (*b*) operations outside the standard geographical limits provided in the policy; (*c*) war risk (such as is ordinarily found in like policies), riots, or civil commotion, malicious mischief, sabotage or any intentional injury or destruction or attempt thereat by any person whatsoever; (*d*) wear and tear, deterioration, conversion by a person in lawful possession of the aircraft, mechanical breakage or structural failure (but not excluding damage caused by the perils insured against even though such damage results from mechanical breakage or structural failure); (*e*) while the insured aircraft is being operated in violation of the regulations of the Civil Aeronautics Administration applying to acrobatic flying,

instrument flying, repairs, alterations and inspections, and night flying, or if the aircraft is operated by any person not approved under the terms of the policy.

When reference is made to the Civil Aeronautics Authority, it is intended to mean the duly constituted authority of the United States having jurisdiction over civil aviation. The geographical limits to which reference is made, as the policy is usually written, include the United States and Canada and into Mexico within 100 miles of the Mexico–United States international boundary. Limits may be extended by agreement.

Liability Coverages. The aircraft liability policies undertake, subject to the policy limits, to pay on behalf of the insured sums that he in turn is obligated to pay by reason of legal liability, by reason of the injury to others or damage to the property of others growing out of the ownership, use, or operation of aircraft. In addition, and included in the aircraft insurance coverages, are the policies designed to protect the liability risk of the owner or operator of an airport or hangar.

The forms of aircraft liability are as follows: (1) public liability, covering bodily injuries to persons other than passengers; (2) passenger liability, covering bodily injuries to passengers while in, entering, or leaving the insured aircraft; (3) property damage, covering damage to property other than that belonging to or in custody of the insured; (4) airport liability, covering the insured's liability for both bodily injury and property damage in the event of an accident. Airport owners and sponsors of meets are insured under the last-mentioned coverage; (5) hangar keeper's liability.

Public Liability and Property Damage. These coverages, with the exceptions to be noted, afford essentially the same insurance protection as the same coverages in automobile insurance. Although the automobile policy covers the passenger hazard, the aviation policy does not, and it makes no difference in the latter case whether the passenger is carried for a consideration or is a guest.

The liability policy does not cover: (1) liability imposed upon or assumed by the insured under any workmen's compensation act or plan; (2) liability for injuries sustained by employees or pupils of the insured while carried upon, or operating, or caring for the insured aircraft, or while engaged in the usual course of trade, business, or profession of the insured.

In the case of property damage the coverage excludes: (1) property belonging to, or in the custody of the insured; (2) property belonging to, or in the control of, the insured's employees or pupils; (3) property which is rented or leased and for which the insured is legally responsible; (4) property carried in or upon the insured aircraft.

When aviation liability policies were first offered, they contained no omnibus clause. As a result, the insurance extended to cover only the person specifically named in the contract. There is now an additional insured clause similar to that to be found in the automobile liability policy. This is effected by a definition of the term "insured." The following is an example:

INSURED.—The unqualified word "Insured" includes not only the Insured name in this policy but any passenger, as herein defined, any pilot, excluding student or renter pilot, while operating and any person legally responsible for the operation of the aircraft described in the Schedule of Particulars. The provisions of this paragraph do not apply:

a) In respect to any loss, covering which there is other valid and collectible insurance;

b) In respect to bodily injury or death suffered by the Named Insured;

c) To any manufacturer of aircraft, aircraft engines or aviation accessories, or any aviation sales or service or repair organization or airport or hangar operator or their respective employees or agents, unless the said manufacturer of aircraft, aircraft engines or aviation accessories or the aviation sales or service or repair organization or the airport or hangar operator is specified as the Named Insured in the policy;

d) To any employee of the Insured with respect to bodily injuries or death suffered by another employee in the course of his employment by the same Insured.

The liability policies contain the same exclusions as to unlawful use, geographical limits, war risk, and Civil Aeronautics Authority certificate as are found in the hull policy. In addition, the policy excludes the workmen's compensation hazard in the following terms:

This policy does not cover liability imposed upon or assumed by the insured under any Workmen's Compensation Act, Plan or Law, nor under any contract or agreement of whatever nature; nor in respect to injuries or death suffered by Employees of the Insured in the course of their employment, or while engaged in the usual course of the trade, business, profession or occupation of the insured.

The policy also excludes any liability in consequence of operation of the insured aircraft in connection with closed-course racing, or operation for, or in connection with, other than uses specified in the policy

unless specifically endorsed thereon, or operation by any person other than the pilot or pilots named in the policy except starting and running of engine and taxiing by licensed pilots or mechanics holding federal airplane or engine mechanics' licenses.

Standard limits for liability are $5,000/$10,000, and for property damage $1,000. The terrific damage that a crashing airplane can do to both the human body and property emphasizes the need of high limits. Nor does it take an accident partaking of the nature of a catastrophe to run the damage claims to huge sums. In the case of property damage the need for high limits, sometimes overlooked, is likewise essential. Taxiing accidents are frequent; and because of the fragile construction of aircraft, a comparatively slight collision has resulted in damage amounting to as much as $15,000.

Individuals learning to fly may protect their individual legal liability for death or injury to members of the public, passengers excluded, under a special form written at a comparatively low rate.

Passenger Liability. The question of the liability of owners or operators of aircraft to their passengers is not definitely settled. This is due to the fact that the status of aircraft passengers has not been established by judicial decisions. If an airplane operating over a designated route is classed as a common carrier, owners are subject to the strict rule of liability applying to that class. This has already been noted in the discussion of marine coverages. Certain states by legislative enactment have declared regular air transport lines to be common carriers.

In the case of privately owned planes used for pleasure or business purposes there is a guest hazard, such as is to be found in the case of the automobile. Anticipating the application by the courts of the same rules in the case of airplanes as are used in that of automobiles, indemnity companies are prepared to assume the passenger liability hazard. Two forms of policy are available. The first covers the risk of passengers carried for hire and otherwise, and the second covers the risk for guest passengers only.

Passenger liability policies are written with a standard limit of $5,000 per passenger seat. Hence, the lower standard limit of an aircraft passenger policy is $5,000, and the upper limit is $5,000 multiplied by the number of passenger seats. Higher limits, as in other liability coverages, are available. In the case of transport lines in particular, the higher limits are recommended.

Admitted Liability Coverage. A form of liability coverage, closely akin in principal to the medical payments in the automobile field, provides that in the event of bodily injury to a passenger, excluding passengers carried for hire, the policy will make payments on a definitely determined basis regardless of whether or not the insured is legally liable. The policy provides that in consideration of the payment of these benefits, there shall be obtained a release from the claimant relieving the insured from any further liability as result of the accident. In the event that a passenger meets with death, the same benefits are payable to his dependents or estate. In the event that the injured passenger refuses to release the insured from further liability, the policy will pay, up to the amount of the benefits indicated, any legal claims for damages that may be established. It is not necessary, however, to establish legal liability if the claimant signs the required release.

The admitted liability policy is issued only in connection with an additional passenger third-party liability policy written for identical amounts. This second policy is written as excess over the first policy, and therefore the premium rates are correspondingly low. This policy has proved attractive in that it permits the owner of a plane to offer passengers an insurance service covering injuries without forcing the injured party to prove negligence on the part of the plane owner for the purpose of establishing legal liability.

Comprehensive Light Plane Policy. A special hull policy has been provided for light planes, that is, planes weighing under 2,000 pounds fully loaded, to cover comprehensive, including crash. The perils are specifically named, but the policy covers a wide range of additional risks, such as earthquake, flood, denting, marring, and the like that are not included in the usual course in the policies written covering specified perils. The term "comprehensive" derives from the wide number of perils included in a single form. Unlike the automobile comprehensive, it is not an all-risks cover. Under the light plane plan the insured bears a portion of the loss in the form of participation and in return, therefore, secures a considerably lower rate than otherwise would be the case.

The policy is written to cover with a $50 deductible effective on all ground coverages except fire, theft, and transportation. This deductible may be eliminated for the payment of an additional premium. The policy, as ordinarily written, provides insurance

against all the named perils with the deductibles and participation as indicated below:

Perils	Deductible	Insured's Participation
Fire (excluding fire following crash)	Nil	Nil
Windstorm	$50.00	Nil
Land damage	$50.00	Nil
Theft	Nil	Nil
Crash (including fire following crash)	Nil	20% to 33⅓% of amount of loss

In the case of crash losses, the participation to be borne by the insured depends upon the usage of the plane and the experience of the pilot. The percentages are as follows:

Named private pilot(s) with over 200 hours	20%
Named private pilot(s) with 100–200 hours	22½%
Named private pilot(s) with under 100 hours	25%
Named student pilot(s) (not more than 2)	27½%
Instruction with approved instructor	33⅓%
Commercial excluding instruction	25%
Flying clubs	33⅓%

Instead of writing the policy on a comprehensive form, with named perils as indicated above, the light-plane policy may be written on an all-risks basis for an additional premium.

Airport Liability. This coverage partakes of the characteristics of the owners', landlords' and tenants' liability policy; but because the risk is peculiar to the business of aviation, it is usually written by insurers specializing in aviation risks.

Airports, whether individually owned, or the property of private corporations, or under municipal management or ownership, may be insured under this form. The policy covers the insured's liability for bodily injury and may likewise be written to include property damage. The coverage protects the insured, not only for his liability for loss to persons or property of visitors to the airport and patrons, but also for claims if planes using the airport meet with accident that may be attributed to his negligence or that of his employees.

In the case of airport liability insurance, an application is required in the case of each risk, and the insurer willing to assume the risk bases his premium charge upon the data supplied in each individual case. The following data are required before fixing a rate: (1) area of the airport in acres; (2) number of lineal feet on highway; (3) how fenced; (4) average number of aircraft located at airport; (5) automobile parking space and whether or not charge is made for parking;

(6) list and description of all buildings on the airport; (7) whether or not there is student instruction; (8) approximate population within ten-mile radius of airport; (9) effective landing length in four directions; (10) description of bleachers or group-seating structures on the airport; (11) system of air traffic control; (12) number of daily stops made by scheduled airlines; (13) whether or not repair work is done by insured; (14) estimated total dollar-amount of sales, and description of all products sold. A plan or sketch may be required showing all pertinent features of the airport.

The airport liability policy is designed to meet primarily the aviation hazards incidental to the operation of an airport. Coverage for airmeets for which an admission charge is made is excluded in the policy, but there is a special form of contract to cover this risk issued by the aviation companies after making appraisal of the hazard involved. The airport liability policy may be written to include incidental liability hazards other than those strictly associated with aviation. There are five divisions in the policy, and liability may be included under as many of these divisions as the insured elects to purchase. They are as follows:

DIVISION 1. PREMISES. The ownership, maintenance or use, for the purposes stated in the declarations, of the premises, as located and described in the declarations, and all operations during the policy period which are necessary or incidental to such purposes, including repair of aircraft and their parts, and ordinary maintenance and repairs on the premises.

DIVISION 2. ELEVATORS. The ownership, maintenance or use, for the purposes stated in the declarations, of any elevator therein designated.

DIVISION 3. ALTERATIONS. Alterations other than ordinary maintenance and repairs, new construction, demolition of or structural alterations in and additions to existing structures at the premises.

DIVISION 4. PRODUCTS. The handling or use of or the existence of any condition in goods or products manufactured, sold, handled or distributed at the premises by the named insured, if the accident occurs after the insured has relinquished possession thereof to others and away from premises owned, rented or controlled by the insured, except equipment or other property rented to or located for the use of others but not sold; and operations covered under divisions 1 and 3 of the Definition of Hazards, other than pick-up and delivery and the existence of tools, uninstalled equipment and abandoned or unused materials, if the accident occurs after such operations have been completed or abandoned at the place of occurrence thereof and away from such premises.

DIVISION 5. CONTRACTUAL. The express undertakings of the named insured designated in the declarations.

From the foregoing, it is at once apparent that the airport liability policy provides a third-party liability coverage parallel to the coverage provided in the ordinary circumstances by the owners', landlords', and tenants' schedule liability policy.

Hangar Owners' Liability. Hangars are frequently owned or leased by air lines, flying services, aviation schools, and aircraft and engine manufacturers. Hangar owners' liability covers the legal liability of the hangar owner for loss or damage to the aircraft in his custody not owned by the insured. The perils insured against are fire and such other perils as may be agreed upon.

Cargo Liability. Policies are written covering the legal liability of the carrying plane for loss or damage to cargo or baggage. Cargo liability is written as a separate form and covers the liability of the aircraft owner to shippers for loss or damage to merchandise for which the air line may be legally liable. Passenger baggage liability covers aircraft owners' liability for loss or damage to passengers' baggage.

Both of these forms are third-party, or liability, coverages and are to be distinguished from the inland marine cargo cover written for the account of merchandise owners against loss or damage caused by agreed perils of air transportation.

Workmen's Compensation and Personal Accident. Because of the nature of the employment of those connected with the aviation industry, personal accident and workmen's compensation coverages for members of this group are sometimes classed as aviation coverages.

In addition to those actually engaged in flying, the aviation industry employs large numbers of workers engaged in many forms of ground work. Compensation insurance is written in accordance with the requirements of each particular state. If no compensation law is in effect, the common-law liability of the employer is insurable under an employer's liability form.

Personal accident policies are available, but they are issued only after careful underwriting. Policies issued to cover pilots are more acceptable to the insurance companies than are those required by passengers who do not wish to be subject to any restrictions as to the type of flying to be covered. Most personal accident policies today cover the risk of travel on domestic scheduled air lines. However, pilots, students, and passengers, in aircraft other than those flying on

established lines secure accident insurance coverage in the aviation insurance market, and the coverages are regarded as aviation lines.

Manufacturers' Risks. Aircraft in production are insured under a blanket policy, and the coverage attaches automatically to each plane as it comes at risk. The policy is written on a reporting form. Premiums are collected on a flying-hour basis for the flight risks and on a per diem basis for the ground risks.

In the case of a new model, before it has completed its test and received its approval certificate from the Inspection Department of the Civil Aeronautics Administration, special premiums are fixed governing the trial period. A manufacturer may have an enormous investment in a model plane that will not reflect in subsequent like models when the plane is once in production. The perils during the test period involve great uncertainty, and insurance covering the replacement cost of the model is of paramount importance to the manufacturer. Crash risks and liability coverages on such planes are usually written to cover for a specific number of flying hours with provision for an additional charge at a predetermined rate for additional hours. The ground coverages are written on a per diem basis. Before a policy is written covering a test risk, a complete survey is made of all the factors that may bear upon the situation and the rate determined on the basis of this survey.

Periodic Reporting Forms. While the usual aircraft policy is written for a term, when a large fleet of aircraft is operated by an insured certain flying coverages, such as crash damage, public liability, passenger liability, and property damage, may be written on a flying-hour basis. Ownership of three or more aircraft is required for this type of policy, and the insured must keep accurate log records and have in force a satisfactory auditing system. Monthly reports are made by the insured, and the premium charge is computed upon this as a basis.

The constant coverages for fleets, such as fire, windstorm, and theft, are not written on a reporting form but are covered for a definite period of time, as in the case of policies covering single planes.

Employer's Aviation Indemnity. This policy provides coverage for executives, salesmen, and other employees who use scheduled air

lines on their employer's business. The policy has for its purpose the indemnification of employers who seek to encourage persons in their employ to make a maximum use of air transport facilities by offering additional compensation in the event of accident.[2]

The insurance covers loss occasioned by death or dismemberment sustained through accidental means by any named employee: (*a*) while as a passenger, boarding, riding in, or alighting from an aircraft operated on a regular schedule by an air line holding an air line certificate from the Bureau of Air Commerce; (*b*) if, while a passenger, either at regular airports or at a place of forced landing, the employee is struck by any aircraft or propeller; (*c*) while awaiting rescue following the forced landing of an aircraft in which the employee was a passenger.

The policy undertakes to indemnify the insured for payments made as the outgrowth of a voluntary agreement to employees so injured or to the legal representatives of deceased employees. Policies as now written provide coverage in the United States, Canada, and Mexico. The policy does not extend to cover payments made on account of: (*a*) suicide, or any attempt thereat by any employee, sane or insane, or death or injury suffered by any employee while insane or intoxicated or while violating law, resisting arrest, or fleeing from justice, or death from disease in any form; or (*b*) death or injury directly or indirectly the result of war, invasion, strike, insurrection, riot, civil commotion, naval or usurped power.

While the policy is issued to cover named employees, additional employees may be included, and coverage is effective from the time their names are mailed or telegraphed to the company for inclusion.

Trip Ticket Personal Accident Policy. Insurance covering personal injury due to accidents is offered to passengers in licensed planes piloted by duly licensed pilots. The coverage is issued in two forms and covers the flying, day by day. The first form covers the perils of death and dismemberment only, while the second form provides the same coverage as the first, plus a weekly indemnity feature for acci-

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[2] It cannot be denied that there is still a prejudice in the minds of many against travel by air. The increasing use of the airplane, however, for passenger transportation indicates that this prejudice is tending to decrease. Aviation underwriters, it is to be noted, continually differentiate between the risk of travel in airplanes operating over established routes by companies regularly engaged in transporting passengers and other aviation risks. The experience of the regularly established companies is such that the underwriters view that class of business with favor.

dental injuries. Rates for this insurance vary with the coverage, and the charge is made for each day of flying.

FOR REVIEW

1. Is there a standard aviation policy?
2. Are all classes and types of airplanes insurable?
3. B has been in the habit of phoning his insurance agent, asking him to issue a binder from time to time on his various fire lines. Has the local agent the same authority with respect to aviation insurance that he has in the field of fire insurance to commit his company to a risk?
4. X purchases an airplane for $4,000. The list price of this plane is $6,000. In the event of a partial loss requiring the expenditure of $1,500 for parts and labor, what is X's position?
5. B owns an airplane which, when not in use, is kept in a hangar at a public airport. A windstorm blows open the doors and damages the plane. Is this a windstorm loss contemplated in the tornado, cyclone, and windstorm policy?
6. Because an airplane is conspicuous and difficult to conceal, can you conceive of a situation in which the theft of an airplane would result in a total loss?
7. Is there any form of aviation insurance that covers the loss sustained as the result of two planes coming together in the air and falling to the ground?
8. Distinguish between land-damage insurance and crash insurance.
9. The B company owns an airplane valued at $10,000, insured under a crash form with a 10 per cent deductible clause. The plane is damaged in the amount of $3,000. The insured contends the company's liability to be $2,700, but the adjuster contends it to be $2,000. Who is right? Explain.
10. X carries a public liability policy on each of his automobiles and on a privately owned and operated airplane. What important difference is found in the aviation policy with respect to claims for personal injury that is not found in the automobile policy?
11. For what term are aviation policies written?
12. B, a pilot, misrepresents his experience, and his incorrect statements are incorporated in an application for crash insurance. What is the position of the insured in the event of a loss?
13. Because of the strict operation of the doctrine of warranties, may a mortgagee safely cover his interest by aviation insurance?
14. As a rule, do aviation underwriters inspect the aircraft they insure?
15. How are aviation rates made, and is there any rate-making agency used by all companies?
16. A new airplane valued at $20,000 is insured with a 10 per cent deductible clause. After the policy has been in force ten months the plane crashes and is totally destroyed. What would be the usual basis for adjusting this loss?
17. Distinguish between employers' aviation indemnity insurance and workmen's compensation insurance.
18. What forms of aviation insurance are written to protect the owner against damage to his own aircraft?

19. What are the coverages provided in the aircraft liability insurance policy?
20. Distinguish between the coverage afforded under the airport owners' and operators' liability policy and the hangar owners' liability policy.
21. The Eagle Aviation Corporation owns and operates an airport in a New England city. It is the only airport in the city and is used as a terminal by air transportation companies. The Eagle Company also owns several planes used for charter purposes. The Eagle Company carries an airport public liability and property damage policy. One of the planes owned by the insured crashes, injuring two persons. Is the insured covered by the airport public liability and property damage policy?
22. What is the liability of an insurance company writing an aircraft public liability policy for injury to passengers being carried in the insured plane?
23. In the month of February, 1937, an air liner flying from Washington to Cleveland ran into bumpy air near Harper's Ferry, Virginia. On one bump the ship dropped approximately 300 feet. Two of the passengers were thrown from their seats, striking the roof so violently that they had to be taken immediately from the plane and sent to a hospital. Suits were filed and damages in the amount of $200,000 were demanded from the air line. It was contended by claimants that the pilot should have warned passengers to fasten their safety belts. The air line based its defense upon the contention that since bumps often come without warning the accident was unavoidable. What is your opinion as to the liability of the air line?
24. It is stated that the owners of Chicago's Merchandise Mart paid $2,500,000 to Chicago & North Western Railroad in order to straddle the railroad yards with its building. The right of the owner of real estate to control of air above his property has from ancient times been regarded as a principle of property ownership. X wishes to prevent aircraft from flying over his property. May he do this? May he claim damages if objects are dropped?
25. A policy for a million dollars covering "full risk" on a test flight of a new Douglas B-19 was written just prior to the outbreak of World War II. This was a short-term coverage providing insurance for a period of test flights. The premium was reported to be in the vicinity of $82,000. This coverage could develop into a claim of a total loss within a few minutes after the initial take-off. Discuss from an underwriting standpoint.
26. Aviation insurers contend that they should have a wide flexibility in quoting rates and that their rates should be exempt from departmental rate approval required of most other forms of insurance under state regulatory procedure. In your opinion, have aviation underwriters a case?
27. Automobile owners carry liability insurance with $5,000/$10,000 limits. Sometimes they carry limits as high as $100,000 or even higher. Claims rarely reach the higher limits. The situation is not the same in connection with aviation insurance. Explain.
28. B, when attempting to land in a municipal airport, damaged his plane through collision with a road roller on a runway under construction. Action was brought against the city on the ground that it was negligent. The road

roller was a piece of equipment used in maintaining the field. Do you believe the owner of the damaged plane has a claim against the city?

29. The employees of an airport removed B's plane from a hangar and failed to stake it properly. Shortly thereafter, as a result of a windstorm the plane was destroyed. Does the owner of the plane have cause for action against the owner of the airport?
30. A taxiing airplane was damaged as the result of a collision with a truck standing on an airport runway. Is the owner of the airport responsible in an instance of this sort? The truck does not belong to the owner of the airport. Does this question differ in any way from the "road roller" question above?
31. A carries full crash insurance, and as a result of an obstruction on a runway his plane is badly damaged. He collects in full from his insurer. What is the position of the owner of the airport with respect to liability?
32. An accident occurs on an airport owned by a municipality. There is little question regarding liability, and if the airport had been privately owned the injured party could unquestionably collect. It is a general rule of law that municipalities are immune from suit for damage committed in the exercise of governmental function. Do you think this rule will operate to relieve a municipal airport from liability? Explain.
33. The X Air Lines is the owner of a plane that crashed into a dwelling and killed the inhabitants. The officers of the air lines contend that there was no negligence, that the accident was unavoidable, and that every reasonable and possible precaution to avoid accident had been taken. In the absence of negligence, they contend there is no liability on their part for damages. Assuming that it can be shown that there was no negligence does it follow that the X Air Lines is free from liability?

Chapter XXIX

EMPLOYERS' LIABILITY AND WORKMEN'S COMPENSATION

Common Law Liability of Employers. At common law an employer is liable to employees for damages due to injury when the negligence of the employer is the cause of the injury. The burden of proof in the case of accidental injuries rests squarely upon the employee to show that there was negligence on the part of his employer, that this negligence was the cause of the accident, and that the employee did not himself contribute to the negligence.

As the outgrowth of judicial decision, in addition to the defense of contributory negligence, it has been further held that when a servant has knowledge of the ordinary risks involved, he is paid for assuming those risks and, therefore, cannot recover for injuries caused thereby. The doctrine has been extended to apply in cases in which the employee continues to work without complaint after the discovery of failure on the part of his employer to afford proper protection. The defense against claims thus afforded is referred to as the "assumption of risk rule." Finally, the common law relieved the employer of responsibility when the cause of the injury was the willful wrongdoing or negligence of a fellow-servant. This defense is known as the "fellow-servant rule."

Early Modifications of the Common Law. The difficulty of an injured employee's establishing a case of liability can readily be understood. Through statutory enactment and a tendency on the part of the courts to interpret the rules favorably to employees, the position of the worker has been somewhat bettered. The class of fellow-servants has been narrowed to include only those who work with the injured person, not the foreman or manager. A statute in 1856 abolished this defense in the case of employees of railroads. Other laws followed but were to a degree nullified by employers who required workmen to sign contracts releasing them from liability.

With the changes brought about by industrial development and the widespread substitution of machinery for hand labor, it became increasingly apparent that the problem of loss due to industrial accidents was still far from a satisfactory solution. In an effort to

correct the situation, there were adopted by a number of states, employers' liability acts by which the position of the employee was immeasurably improved. These laws were followed by workmen's compensation legislation, which completely revolutionized the law of liability as between master and servant.

Employers' Liability. The employers' liability legislation was the outgrowth of a recognition of the need of liberalizing existing law in favor of the employee. The English laws of 1875 and 1880 mark a turning point in liability legislation. Under the law of 1880 the employer was held responsible for defective machinery when it was the cause of an accident, as well as for the negligence of foremen and others in authority. The old rules of liability were otherwise broadened. This law is important as serving as a model for the laws subsequently adopted by a number of states in the United States.

Employers' liability acts were fought every inch of the way in the courts, and certain of the earlier acts were declared unconstitutional on one ground or another. Defects in the earlier laws were corrected. The Federal Employers' Liability Act of 1906 was held unconstitutional, but upon its re-enactment in a new form it was upheld by the United States Supreme Court. This law abrogated the fellow-servant rule and modified the operation of the rules of contributory negligence and assumption of risk. Finally, the law provided that contracts or other devices intended to exempt the employer from liability created by the act shall be void.

Employers' liability acts in all but a few jurisdictions in the United States have been superseded by workmen's compensation laws. Even though the liability acts were designed to improve the position of the employee, and in fact did accomplish this, they were, nevertheless, far from satisfactory. Negligence on the part of the employee was still a factor, and many accidents occurred where negligence could not be shown. Great expense was occasioned by both employer and employee in litigation, and the award of a jury in any case was beyond anticipation. Even when the legal liability of the employer was covered by insurance, the injured person enjoyed no benefit under the policy, and the company assumed the obligation of defending suits as a basis for determining the insured's liability, if any, to the claimant.

Workmen's Compensation Laws. The theory behind workmen's compensation legislation completely disregards the old idea of lia-

bility based upon negligence. Rather, the theory is based upon the idea that neither the employer nor the employee is to be burdened with the cost of accidents, but that this cost is to be charged as a part of the cost of production to be borne by the consumer.

As a first step to the accomplishment of this end, compensation laws make the employer responsible for indemnity to the injured employee without regard to the matter of fault or negligence. The amount of indemnity to apply in particular cases is predetermined by the law and is sufficient to provide relief for the injured workman, although it does not equal the compensation received while employed. The laws undertake to make indemnities correspond to injuries, and if the injuries are fatal, benefits are provided for the employee's dependents.

Effect of Early Opposition. Just as employers resisted the trend toward liberalization under the employers' liability acts, so they questioned the constitutionality of the first attempts toward the establishment of the compensation principle. The New York Legislature was the first to enact a compensation law. The law was passed in 1910 and was modeled upon the English law of 1897. A test was immediately made of the constitutionality of the act. The court held that the statute that sought to impose a liability upon an employer "who has omitted no legal duty and has committed no wrong" was unconstitutional in New York. Proponents of the act then set about to amend the state constitution. The amendment was adopted in 1913, and a new compensation law enacted in 1914.

In the period between 1910 and 1914 a new plan was evolved to overcome the constitutional difficulties. It was pointed out that if a law were enacted and the employer were given a choice as to whether or not he would be governed by it, the constitutional problem was solved. The employer and the employee might, if they wished, retain their rights at common law, or they might elect to be governed by the provisions of the compensation law. Since the courts had already passed upon the right of the legislature to abrogate the common-law defenses, as an incentive to employers to avail themselves of the compensation act, the elective laws provided that an employer loses the defenses of contributory negligence, negligence of a fellow-employee, and assumption of risk by an employee if he fails voluntarily to become an assenting employer. With the loss of the common-law defenses and the uncertainty as to jury awards, plus litigation costs,

the compensation alternative offers an attractive haven. It follows, therefore, that although, as a matter of theory, employers are entirely free to elect to be bound by the act or not, the choice is, as a matter of fact, so one-sided that employers find it desirable to assent.

As a result of court decisions and legislative enactments, there are two types of compensation laws in force. In one instance compensation is compulsory, and in the other instance it is elective. The New York law as finally passed and held constitutional is compulsory. The vast majority of states have adopted the elective plan, under which form of law the matter of assent to the act is voluntary, and in some states employees may exercise an option. Where a choice is afforded employees, they are usually presumed to have assented unless they specifically indicate the contrary.

Terms of the Laws. In the beginning, workmen's compensation laws were enacted to protect employees engaged in certain industries regarded as hazardous. The tendency in compensation legislation has been to enlarge the scope of benefits, and exemptions of classes of employees differ with the different jurisdictions. No state at present brings all occupations within the operation of the law. Agricultural, domestic, and casual labor is ordinarily exempted, and it is usual to exempt employees when an establishment engages less than a designated number of workers.

Compensation is provided for all injuries arising out of and occurring in the course of employment. No benefits under compensation acts are allowed for the injury or death of an employee when it is proved that such was occasioned by the willful intention of the employee to bring about the injury or death, or that the injury or death resulted from the intoxication of the employee while on duty. An exception to the regulation covering intoxication is sometimes made if the employer knew that the employee was intoxicated, or that he was in the habit of being intoxicated, while on duty.

While the benefits differ in different states, there are points of similarity in all the acts. Definite schedules of benefits are provided for different types of injury. While in certain cases, lump sum settlements may be made, it is usual to provide for the payment of benefits on a weekly basis. To discourage malingering, the weekly benefit is set at a fraction of the injured employee's weekly wage. This ranges from 50 to 66⅔ per cent of the average weekly wage, subject to a sum set as a maximum and another set as a minimum. Thus, a state might

allow 66⅔ per cent of the injured employee's weekly wage, but would in no case allow a sum in excess of $18.00 or below a minimum of $8.00. When the law provides a minimum, it does not mean that an injured employee whose average wage is less than the minimum will receive the minimum amount as compensation. It operates rather to prevent the application of the percentage of the weekly wage allowed to reduce a wage below the designated minimum.

In order to eliminate the excessive expense of handling small losses and to prevent malingering when the injury is of no serious consequence, most laws provide a period of from a few days to two weeks during which no compensation is paid. This interval is called a "waiting period." Some laws provide that in cases of serious injury involving a protracted period of payments, indemnity shall be payable from the date of the injury, regardless of the waiting period.

An important feature of compensation legislation is the fixing with as much detail as possible the exact benefit due in each specific type of injury. Substantial variations appear in the provisions of the acts of the various states, but the following injuries or disabilities are usually specifically provided for: (*a*) fatal, (*b*) temporary total disability, (*c*) permanent total disability, (*d*) temporary partial disability, and (*e*) permanent partial disability. Some laws provide benefits in the case of such disfigurements as might be a handicap in securing employment, while others make provision for disability due to an occupational disease.

Occupational Diseases. Occupational diseases are defined as diseases peculiar to the occupation in which the employee is engaged and due to causes in excess of the ordinary hazards of employment. In recent years, suits claiming compensation for diseases developing from exposure to chemical fumes and dust, skin abrasions, frostbite, and the like have come increasingly to the attention of employers.

Liability for occupational disease is based upon the common-law doctrine requiring the employer to use all reasonable precautions to safeguard the employee from injury and to warn him of the existence of any particular danger.

There are two methods of covering the occupational disease hazard under existing law. Some laws provide compensation for every injury, including diseases, resulting from the employment. Such a law is regarded with disfavor by employers and insurers. They base their attitude upon the testimony of physicians that there are few

diseases that are gradually contracted that may be attributed with any reasonable degree of certainty to the occupation of the affected person, and these may be listed without difficulty. The all-inclusive provision, it is felt, tends to create doubts in the minds of all parties concerned and causes needless and wasteful litigation. A solution of the difficulty is offered in the method used in New York and a number of other states. In these states a schedule of well-recognized occupational diseases is drawn up, to which other diseases may be added when industrial changes lead to new diseases traceable to an occupational risk.

Competent insurance authorities have agreed that legislation on occupational disease will most satisfactorily meet the needs of all interested parties if a supplemental act is passed by the states, rather than an amendment to extend present acts. This is so because of the differences in the nature of accidents and disease. The act covering compensable disease will require special provisions for administration, diagnosis, examinations, methods of award and review. Such an act will tend to eliminate much of the uncertainty that exists at the present time, particularly in those states where the law is broad enough to make occupational diseases compensable without specifying a schedule of such diseases.

The problem both to insurers and to employers created by the inclusion of occupational diseases within the scope of workmen's compensation is a serious one. Insurers and insured alike have raised two questions: first, since occupational diseases in general are progressive and recurring, at what point of time does liability for compensation begin; and, second, which employer, in the event there are more than one, is liable? The trend of court decisions indicates the answers. When inability to work or earn because of certain express conditions occurs, the case is compensable. In other words, compensation starts from the time of actual disability. It has been held that employees are insured "in their then condition," and if their employment causes a disease to continue until they are incapacitated, the insurer at the time of the incapacity is liable.

The seriousness of the situation becomes evident when it is realized that an employee may be suffering over a long period from an occupational disease that is progressive in its nature. Many times, subsequent to the onset of the disease, he may have changed his employment, yet the employer for whom he is working at the time his

disease reaches a stage resulting in incapacity must bear the entire brunt of the compensation.

The Universal Standard Policy. Because of the differences in the compensation laws of the various states, with a wide range in benefit schedules, it appeared that different forms would be necessary to meet the requirements of different states. The insurance carriers recognized that variations in the forms in use would tend to create confusion. To eliminate this difficulty and to eliminate further the possibility of competition between insurers on the basis of breadth of coverage, company executives undertook to develop a standard form sufficiently broad to meet the requirements of insureds and provide the coverage required by the laws of each jurisdiction. As the result of much hard work and many conferences between representatives of insurers and industrial accident commissions, a policy form was drawn up that proved acceptable to all parties. The form is known as the "Universal Standard Workmen's Compensation and Employers' Liability Policy," and it is accepted as standard throughout the United States and used by important insurance carriers.

One important provision of this policy makes the liability of the insurer fit the compensation law of the state in which the insured carries on his business or operations. The significance of the use of a standard form from the point of view of the insured lies in the fact that one company is not able to offer a more liberal contract than is another.

Declarations. As a basis for writing the policy, certain declarations are made by the insured. Relying upon the truth of the statements or upon the good faith of estimates, the company assumes the risk. These declarations comprise: (1) the name and address of the employer and the form of organization, whether individual, copartnership, corporation, or estate; (2) the period during which the policy is to remain in force; (3) the location of all factories, shops, yards, buildings, premises, or other work places of the employer, by town or city, with street and number, together with all business operations and estimated remuneration of employees by classification, the minimum premium and the estimated advanced premium being given; (4) the remuneration and description of employees, including all persons employed together with an agreement to permit the company to examine the insured's books at any time during the policy period and within one year after its final termination, in order to

audit the pay roll during the period the policy was in force; (5) a statement of business operations carried on at locations not to be covered; and (6) a statement of any workmen's compensation insurance canceled by a carrier during the preceding year.

The Risk Covered. The Standard Workmen's Compensation and Employers' Liability Policy affords the insured a twofold coverage. The obligations placed on the insured by the workmen's compensation act are assumed under the first part of the insuring clause in the following terms:

ONE. (*a*) TO PAY PROMPTLY to any person entitled thereto, under the Workmen's Compensation Law and in the manner therein provided, the entire amount of any sum due, and all installments thereof as they become due,

(1) To such person because of the obligation for compensation for any such injury imposed upon or accepted by this Employer under such of certain statutes, as may be applicable thereto, cited and described in an endorsement attached to this Policy, each of which statutes is herein referred to as the Workmen's Compensation Law, and

(2) For the benefit of such person the proper cost of whatever medical, surgical, nurse or hospital services, medical and surgical apparatus or appliances and medicines, or, in the event of fatal injury, whatever funeral expenses are required by the provisions of such Workmen's Compensation Law.

It is agreed that all of the provisions of each Workmen's Compensation Law covered hereby shall be and remain a part of this contract as fully and completely as if written herein, so far as they apply to compensation or other benefits for any personal injury or death covered by this Policy, while this Policy shall remain in force. Nothing herein contained shall operate to so extend this Policy as to include within its terms any Workmen's Compensation Law, scheme or plan not cited in an endorsement hereto attached.

The second section of the clause assumes the public liability obligations of the insured as follows:

ONE. (*b*) TO INDEMNIFY this Employer against loss by reason of the liability imposed upon him by law for damages on account of such injuries to such of said employees as are legally employed wherever such injuries may be sustained within the territorial limits of the United States of America or the Dominion of Canada. In the event of the bankruptcy or insolvency of this Employer the Company shall not be relieved from the payment of such indemnity hereunder as would have been payable but for such bankruptcy or insolvency. If, because of such bankruptcy or insolvency, an execution against this Employer is returned unsatisfied in an action brought by the injured, or by another person claiming by, through or under the injured, then an action may be maintained by the injured, or by such other person claiming by, through or under the injured, against the Company under the terms of this Policy for the amount of the judgment in said action not exceeding the amount of this Policy.

Where the insured is operating under a compensation act, the terms of the particular act applying in the case of the insured are read into the policy, and the company assumes the liability to pay compensation benefits provided by the act and to pay medical, surgical, nurses', and hospital fees in accordance with the terms of the act. In the event of fatal injuries, the company assumes the funeral expenses provided in the act, as well as benefits provided for dependents.

In those states providing employees with an option as to whether they will come under the protection of the compensation act, an employer may find himself faced with a common law or employer's liability claim. In other states the compensation act does not include all occupations. The section of the insuring clause covering the insured's legal liability for injuries is broad enough in its scope to provide liability coverage on employees who waive compensation, as well as on those employees engaged in operations not included in the compensation act.

Paragraph one (*b*) is without limitation as to liability; but, as a matter of practice, companies set a limit by endorsement, the usual practice being to place a maximum of $25,000 for liability in any one accident. The policy as drawn without endorsement leaves open the question of liability for occupational disease. This being the case, when it is not the intention of the insurance company to assume this liability, legal liability for occupational disease is excluded by endorsement. On the other hand, if it is the intention of the company to cover the risk and the intention of the employer to purchase this protection, a standard form of endorsement describing the coverage is attached to the policy, and an additional premium charged therefor.

Service, Defense, and Costs. The policy provides that upon notice of injury the company will undertake to investigate the claim and proceed with a settlement in accordance with the law. When suits are instituted against the employer by an employee, the company obligates itself to defend in the name of the employer such suits or other proceedings instituted against him on account of injuries. This clause extends protection in cases in which injuries are alleged and damages or compensation claimed even though the demands are groundless, false, or fraudulent. The company further assumes the liability for: all costs levied against the insured in a legal proceeding defended by the company, interest accruing after the entry of judgment; and expense incurred for investigation, negotiation, or defense.

Employees Covered. The policy provides that all employees are covered whose entire remuneration is included in the pay roll upon which the premium of the policy is computed and adjusted. Since one of the statements required in the declarations is to the effect that the pay roll data given are complete and include all employees, the policy covers all employees of the insured employed in the operation of his business. An increase in the number of employees, or substitutions subsequent to the inception of the policy, are thus brought within the scope of the protection. Injuries sustained by officers employed by a corporation are covered, and it is not required that their full remuneration be included in the pay roll for the purpose of computing the premium charge, unless the employed officer is performing duties such as are ordinarily undertaken by a superintendent, foreman, or workman.

Insurers' Liability to Employees. The workmen's compensation policy introduces a feature hitherto not found in liability coverages. The policy, in addition to protecting the named insured, states that the provisions of the insuring clause relating to workmen's compensation or employers' liability are the direct obligation of the insuring company to any injured employee or, in the event of his death, to his dependents. Since the contract is made primarily for the benefit of employees and their dependents, they have a direct right of action against the company and are in effect insureds under the policy as much as if specifically named.

For the further protection of the employee, the policy provides that the obligations of the insuring company to him shall not be affected by the failure of the employer in any way to comply with the policy requirements. Further, a default by the employer in the payment of the premium after an accident will not jeopardize the position of the employee. Failue to give the company the notice required by the policy does not react to the disadvantage of the employee, nor does the death, insolvency, bankruptcy, legal incapacity, or inability of the employer. The placing of the employer's business in the hands of an executor, receiver, trustee, assignee, or other person does not in any way affect the responsibility of the company to the injured employee.

A notice to the employer of an accident is presumed to be notice to the company, so far as any obligation rests upon the injured party, and the knowledge of the employer is held to be the knowledge of the

insurer. The jurisdiction of the employer is presumed to be the jurisdiction of the insuring company. The policy provides that the insuring company shall in all things pertaining to the coverage be bound by the findings, judgments, awards, decrees, orders, or decisions rendered against the employer.

Operation Covered. The policy undertakes to cover the business operations of the insured as set forth in the declarations. For the purposes of the insurance the policy provides coverage for "all operations necessary, incident or appurtenant thereto, or connected therewith, whether such operations are conducted at the work places defined and described in said Declarations, or elsewhere in connection with, or in relation to, such work places."

In connection with this insurance, the employer is obligated upon the happening of an accident to give the company immediate written notice, in which is incorporated the fullest information obtainable at the time. Companies as a rule furnish blanks for the purpose, and, since these indicate the nature of the information required, their use somewhat simplifies the task for the insured. The blank does not set a limit to the information required, and any unusual circumstance connected with the accident should be included in the report. A like notice is required immediately upon the filing of any claim because of the accident, and if any suit or other proceedings are filed against the employer, the policy obligates him to forward immediately to the company every summons, notice, or other process served upon him.

If the employer carries other insurance covering the same claim, both policies contribute to the loss. The policy condition provides that the employer shall not recover from the company a larger proportion of any claim than the sum insured bears to the whole amount of collectible insurance. This clause is like the contribution clause of the fire policy. In practice it is of little importance, for compensation risks are rarely divided between different insurers. One company usually assumes the entire risk, regardless of its size and exposure, and adjusts its own position through reinsurance.

Policy Term. Compensation policies are written for a term of one year. The term is set forth in the declarations. Contrary to the custom followed in the fire insurance business, policies run from midnight to midnight in compensation coverages, instead of from noon to noon.

Cancellation. The policy may be canceled at any time by either

party upon written notice. The notice must indicate the date when cancellation is to be effective, but this date must be not less than ten days after the notice is given, and if the law of the state requires that notice be given to any board, commission, or other state agency, this condition must be complied with as well.

Insureds sometimes feel that in the event of cancellation they should be asked to pay a premium only upon the actual pay roll expended to the date of cancellation. This is not the rule. The remuneration of employees for the policy period stated in the declarations is computed. Then, if the cancellation is made at the company's request, the earned premium for the period the policy has run is adjusted on a pro rata basis, using the computed remuneration for the term stated in the declarations. The short-rate cancellation is effected if the contract is terminated by the insured. In no instance is the retained premium less than the minimum premium stated in the declarations. One exception to the foregoing rule is to be noted. If the cancellation is made by an employer who is actually retiring from the business covered by the policy, the earned premium may be adjusted on a pro rata basis.

Subrogation. In any case in which the company makes an adjustment and persons outside the protection of the policy have contributed to the loss, the company is subrogated to the extent of its payment to all rights of recovery vested by law either in the insured employer or in the employee or his dependents to whom the claim is paid.

Endorsements. It is provided that no condition or provision of the policy shall be waived or altered except by written endorsement attached thereto. The policy states that notice to an agent, or knowledge possessed by an agent or any other person, shall not be held to effect a waiver or change in any part of the contract. The insured under the policy terms agrees that the policy embodies all agreements then existing between himself and the company or any of its agents relating to the insurance.

Since circumstances arise making changes in the policy necessary or desirable, a space on the form is set apart for endorsements. When so attached, after being executed by the duly authorized officers of the company, they become in fact a part of the contract. Endorsements are used for such purposes as to incorporate a change of rate into the agreement, to extend the policy term, to change the address of the

employer, to eliminate medical service, to cover additional locations, to extend the coverage to a different class of operations, to extend the coverage to different states, to name additional insureds, and to make other changes to which the company may willingly consent.

The compensation policy ordinarily provides that endorsements must be signed by an officer of the company, usually the president, vice-president, secretary, or assistant secretary. An endorsement countersigned by a resident agent of the company and attached to the policy is held to be insufficient to effect the required change.

Computing the Premium. The premium of a workmen's compensation policy is based upon the entire remuneration earned during the policy period by all the employees of the insured engaged in the business operations described in the declarations, subject to a minimum premium, which is considered to be earned regardless of the actual pay roll.

The minimum premium is based upon the manual rate for a pay roll of $1,000 plus $8.00. The companies are unwilling to assume a risk unless a premium yield will be equal to that afforded by a pay roll of $1,000. The minimum premium for which a policy may be issued is set at this amount plus $8.00, which is the computed cost of issuing and administering the policy for a year.

Under the classification of employments, following each occupation in the manual, is a code number. Reference to the code number in a second section of the manual will give a rate and the minimum premium for the classification. The rate thus found is applied to each hundred dollars of pay roll for the classification. Thus, to find the premium for a given risk, one must group all the employees by classifications. The pay roll applying to each classification is computed and the rate applied. The total of the premiums for each classification represents the premium for the risk. When there are a number of different classifications, the minimum premium is that shown in the manual for the classification having the largest pay roll.

One who computes a compensation premium construes the term "pay roll" to mean compensation received. It therefore includes all salaries, wages, and earnings of every sort, whether the employment is regular, part-time, piecework, or homework. Tips, bonuses, or allowances of any character, when regarded as an incentive to the employee to continue in his occupation, constitute part of the remuneration. When meals and lodgings are allowed, or other substitute for cash

payment is made, the cash value of such substitutes is part of the pay roll for the purpose of computing the compensation pay roll.

In addition to the premium computed by applying the rate found in the manual to the different pay roll classifications, in some jurisdictions a flat charge of $10 is made if the annual premium is less than $300. This charge is termed the "expense constant" and is a loading charge designed to equalize the expense ratio between large and small risks. The expense constant is added to the actual premium and, therefore, does not operate to increase the minimum premium.

When the policy is written, an estimate of the pay roll for the policy period is made. An estimated premium is computed and paid. The estimated premium is adjusted at the end of the policy term on the basis of the actual pay roll as brought out by an audit.

Merit Rating. The manual classifications with rates promulgated for each serve as the initial step in apportioning premium charges on the basis of the hazard. No classification has, however, ever been devised that is sufficiently close to eliminate differences of hazard within classifications. For example, the owner of Plant A may have installed every known safety device for the protection of his workmen, while the owner of Plant B is reluctant to spend money for safety appliances. While coming within the same rating classification, the hazard in the second case is far greater than that in the first. The inequity of a system that fails to take such differences into consideration is at once apparent. The problem is solved through the agency of merit rating.

For the purpose of merit rating, there are two methods of rate modification: schedule rating and experience rating. Schedule rating is adapted to risks when there is substantial mechanical hazard. Standards are prescribed for safeguarding machinery, elevators, floor and wall openings, electricity, molten metals, boilers, cranes, conveyors, and other physical equipment. When proper safeguards are installed and the hazard meets the requirements set for standard, a credit is given in the rate. Schedule rating is available only to risks in the industrial or manufacturing classification and in even these classifications has now been discontinued in all but a few states. The plan met with opposition because it was believed to be used in some instances as a means for rate cutting when credits were allowed by the company. When the work of inspection was transferred to a supervisory bureau, friction often developed between the bureau inspectors and the engineering staff of the insurance carrier. The ap-

plication of merit rating now finds its widest acceptance in the plan known as "experience rating."

Experience Rating Plan. Experience rating bases its findings upon the past experience of the particular risk under consideration. For the purpose of experience rating, the experience of the particular risk is compiled in much the same manner that data are collected for arriving at the manual classifications. If the accident history shows a cost below normal for the class, a credit in the rate is allowed, while an unfavorable experience results in a debit. This credit is applied to the manual rate to find the new or adjusted rate. When the risk is very large, the experience is the sole basis for composing the rate without reference to the manual. Such risks are said to be self-rated. To qualify for experience rating, the risk must produce a designated minimum premium figured at manual rates. In a large number of states, the minimum premium required is $1,000, although there are variations, according to states, some requiring $400, $500, $600, $700, and $800. For the purpose of determining experience, the plan requires a period of not less than one year and not over five years, although the rule is not the same in all states.

The term "standard premium" is used to designate that premium determined by applying manual rates to the employer's pay roll modified by either experience rating or schedule rating. In those instances where the annual standard premium exceeds $1,000 the insured may choose one of four plans that will further modify the premium charge. These include (*a*) the premium discount plan, and (*b*) three retrospective rating plans.

The Premium Discount Plan. Workmen's compensation rating plans recognize that certain factors that enter into the premium charge do not increase proportionately as the premium increases. The principal factors considered are: (*a*) losses, (*b*) claim expense, (*c*) engineering and accident prevention, (*d*) administration and pay roll audit expenses, (*e*) acquisition costs, and (*f*) taxes. Under the premium discount plan a definite portion of the first $1,000 of premium is allocated for company expenses and acquisition costs. As the premium increases, credit is given for those expenses that do not increase proportionately. For example, the first $1,000 of premium is standard. Premium in excess of $1,000 is grouped in brackets, and a discount applied. The discount is greater in the higher brackets. The net effect of this plan is to provide a reduction from the standard pre-

mium as the premium increases in amount. The theory upon which these premiums are computed is sometimes referred to as the "principle of graded expense."

The premium discount plan, in contrast to the retrospective plans presently to be noticed, does not provide for a modification of the premium as a result of current loss experiences. It does, however, take into consideration past experience, since the discount is applied to the standard premium, which, in turn, is modified by experience rating. The discounts applied for are for the purpose of reflecting a lower ratio of expenses and acquisition cost to premiums in the higher brackets. The net effect is to provide a lower premium than would be the case if the standard rates applied uniformly to the entire pay roll.

Retrospective Rating Plan. The most recent development in compensation rating is the retrospective plan. This plan is not separate and apart from schedule and experience rating but is, in effect, supplementary. While experience rating looks definitely to the past to determine the rate for the future, retrospective rating permits the insured to influence his premium by his current performance. The retrospective plan provides for the determination of a basic premium, which is a percentage of the standard premium, developed by applying the regular manual, schedule, or experience rates to the pay roll of the insured. A basic premium ranges from 21.5 to 30 per cent of the standard premium and is designed to cover administrative items such as inspection, pay roll audit, and partial claim expenses.

There is a loading to provide for losses that develop in excess of the maximum premium determined upon; and provision is also made for taxes, acquisition costs, based upon the minimum premium, and other administrative items.

The plan provides for three premiums: (1) minimum retrospective premium, (2) maximum retrospective premium, and (3) retrospective premium. The plan provides that the insured shall pay, in any case, the premium known as the "minimum retrospective premium." On the other hand, he is protected in that he never may be called upon to pay more than the maximum retrospective premium. The premium he will actually pay will probably fall somewhere between the two; this is known as the "retrospective premium" and is determined by adding to the basic premium the losses incurred, modified by a conversion factor to provide for administrative and

claim adjustment expenses. Under the plan, the premium charged may be the minimum retrospective premium, and this is considerably less than the manual rate. It may be more than the minimum retrospective premium, depending upon the experience of the risk, but the possibility of excessive losses is cut off by the provision that the premium may never exceed the maximum retrospective premium.

The retrospective rating plan gives the insured the same credit for decreasing administration and acquisition expenses as does the premium discount plan. In addition, however, the retrospective rating plan reflects current losses in the current premium charge. From the standpoint of the insured, this is particularly attractive because he gets immediate credit for such care as he may exercise in reducing his loss experience. From the point of view of the insurance company, it is equally attractive because anything that will stimulate activity on the part of the insured to cut his losses will in the long run reflect to the benefit of the insurance carrier.

There are three forms of retrospective rating, known as plans A, B, and C. These plans are alike in principle but vary in detail, principally with reference to the fixing of the maximum and minimum premiums. In addition, several states have adopted retrospective plans of their own. All of the plans, however, are alike in that they aim to have the current premium predicated upon the loss experience of the current year.

Compensation Rates. Compensation rates, as in the case of rates for other forms of insurance, have their basis in statistical experience. For the purpose of compiling the necessary statistical data, the compensation rate is divided into two parts. The first of these is the pure premium and includes the costs of benefits and medical services. The second part of the rate is the loading and provides for the expense factor in conducting the business.

Under the rating plan now in effect, risks are grouped on the basis of the hazard involved. These groupings are termed "manual classifications" and represent in some instances industries and in other instances occupations.

The data covering losses are used to determine the pure premium and are compiled separately for each state. The original method was to accumulate data for each manual classification, but recent developments have led to the establishment of the so-called "Unit Statistical Plan," which better meets the need of new developments. The Unit

Statistical Plan calls for a report of each individual risk, instead of each manual classification. This plan makes it possible to check reports against the records of industrial commissions and, moreover, provides reports that correspond with experience rating used in the Experience Rating Plan. The data are compiled on a state basis because of the differences in compensation benefits in different jurisdictions. Conversion factors are computed by comparing the benefits afforded in the different states with a base, and by means of this factor the data of the various state schedules are converted to a national level.

It was early recognized that some unity must be effected in compensation charges, not only within the jurisdiction of a single state but also among all of the states. With this end in view a conference of interested parties was called in 1915 that resulted in the organization of the National Council on Compensation Insurance.[1]

On the basis of statistical information supplied by member companies this bureau issues a manual, quoting rates per $100 of pay roll, as well as the rules and regulations under which workmen's compensation insurance is written. The manual of the council is recognized in all jurisdictions, and the rates quoted are the bases for computing compensation premiums by insurance carriers. In those states where there are independent bureaus, there is active co-operation with the council.

Second Injury Funds. With the advent of experience rating, and more particularly with the advent of retrospective rating, the attention of the insured has been focused on all factors that may contribute to his loss experience and hence his workmen's compensation cost. Great emphasis has been placed upon accident prevention service, and it has been a natural sequence to carry the attention of the insured from accident prevention to physical factors. This has directed attention to incapacitated employees and more particularly to employees so incapacitated that a second injury would result in total disability.

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[1] It is provided in the constitution of the National Council on Compensation Insurance that its object shall be: (1) the making of rates for workmen's compensation insurance; (2) the collection and tabulation of statistics bearing thereon; (3) the development of rating plans and systems that will not only measure the hazard of each risk but that will produce the greatest possible accident prevention effect; and (4) the administration of such rates and rating systems in the interests of the insured, the carrier, and the public.

The term "second injury" in compensation parlance refers to an injury that taken in connection with a previous injury will result in an incapacity greater than would have been the case had there been no previous injury. For example, persons who have lost an eye, or a hand, or are otherwise partially incapacitated, quite definitely could become totally incapacitated as a result of another injury that, in itself in the ordinary course, would not have resulted in total incapacity. Unless the statutes provide specifically to the contrary the cost of disability arising out of the second injury reflects upon the employer in whose employ the second injury is sustained. The end result of this situation is to place an undue burden upon the employer who retains in his employ the person who is already seriously injured.

To counteract this situation, a number of states, by statute, have limited the liability of the employer in such instances to payment for the disability resulting only from the second injury. The statutes in such circumstances provide that such injured workmen, after having received all of their regular compensation benefits from their employers, will be entitled to additional weekly benefits during the continuance of incapacity, the outgrowth of a so-called "second injury." These additional benefits are paid out of a "second injury fund" administered by the state. It is usual to provide that the fund be financed by contributions from insurance companies or mutual associations writing compensation insurance. Payments for the second injury disabilities are made out of this fund. If the injury is total, special compensation is provided. It is also provided that if the injured workman is able to secure employment, but not at the level at which he was previously employed, he may receive compensation based upon the difference between his present weekly earnings and the weekly earnings before the second injury occurred.

Excess and Deductible Average Policies. In the interests of lower premium charges, insureds have sometimes preferred to assume losses up to an agreed point. Coverages of this kind have been written under two forms. The first insures against loss in excess of a designated amount arising from a single accident. Such a coverage is termed "excess insurance." The second form is the same in principle, but applies the policy limitation to each claim, instead of to a single accident. This form is called "deductible average insurance."

These coverages are considered unsatisfactory from the insurance carriers' standpoint and for that reason are rarely written. Insurance

companies prefer that risks with a low loss ratio reduce insurance costs through merit rating. There is a grave danger that important hazards will be overlooked by an insured who knows that his losses are covered by insurance. When every loss has a bearing on the insured's costs, care is taken to eliminate all hazards. This lessens the possibility of catastrophes, as well as of occasional accidents.

Inspection Service. The insuring company undertakes to inspect the work places covered and to suggest to the insured such changes or improvements as may operate to reduce the number and severity of accidents.

Sometimes insureds have been impatient with company inspectors and inclined to believe them too exacting in their suggestions. This attitude is found only in the occasional case. For the most part, insureds realize that industrial accidents are a source of monetary loss. Work is interrupted, and employees, foremen, superintendents, and others lose time from productive effort; machinery is broken and goods spoiled because of the mental upset of witnesses to the accident. These and other factors tend to make the cost of industrial accidents a serious drain, even though the employer's obligation to the injured man is covered by insurance.

Inspection service is becoming an increasingly important factor in the placing of compensation insurance. Some companies have organized highly specialized engineering and research services for the purpose of investigating and studying extra-hazardous working conditions and of devising, if possible, safer methods and conditions. In new manufacturing processes, where there is no previous industrial experience, the expert knowledge of experienced research engineers proves of great assistance in discovering safe methods. If a favorable experience is reflected in the rate, the direct saving is often substantial.

Employers' Liability Insurance. Workmen's compensation insurance is now by far the most important of the coverages written to insure industrial accidents. Employers' liability coverage is still used occasionally by an employer to protect himself when his employees do not come within the scope of a compensation law.

With the exception of the insuring clause, the employers' liability policy is substantially the same as the workmen's compensation form. The insuring clause covers the insured's legal liability for personal injuries sustained by employees. The policy undertakes to indemnify

the policyholder against loss or expense arising, or resulting, from claims upon him for damages on account of death or of bodily injuries accidentally suffered, or alleged to have been suffered, by his employees. Under this form the employee has no rights against the insurer, but makes his case directly against the employer, as if insurance were not a factor. The insurance company defends the case in the name of the insured and effects a settlement or pays judgment and costs, subject to the policy limits.

Unlike workmen's compensation coverage, limits are set under the employers' liability form, as in the case of other liability coverages. Standard limits are $5,000 for a single claim and $10,000 for a single accident. Upon the payment of an additional premium, higher limits are written when required.

No provision is made to compensate the insured for any sums expended in providing medical aid in the case of accidental injuries under an employers' liability coverage written at manual rates. The manual rate provides for legal liability insurance, and upon payment of the required premium a medical aid coverage may be provided. The coverage is provided in two forms: (1) first aid, and (2) full aid. When medical aid coverage is made a part of an employers' liability policy, the benefits of medical treatment are not contingent upon the establishment of legal liability on the part of the insured.

The Audit. The right is reserved to the insurance company under the compensation policy to examine the books of the insured to determine the actual pay roll expended during the time the policy was in force. This right does not terminate until a year after the expiration of the policy. Insureds, in times past, have been reluctant to turn their books over to an outsider, and occasionally an insured is found who regards an audit as unwarranted. The practice by the insurance companies of employing auditors trained in this branch of the business has become established, and an insured is obligated to supply the books needed for the purpose.

Since the premium under a workmen's compensation policy is based upon the pay roll, but the rates vary with the classes of work performed, it is essential that the insured segregate his pay roll expenditures into the manual classifications applying to the operations of the insured. Obviously, a sum representing the total pay roll for the period is entirely inadequate for an equitable computation of premium except in the most unusual case. In the interest of both

insured and company an accurate classification is necessary, and if the insured keeps his records with this in view, the task of auditing is materially simplified.

As a means of assisting the auditing department of an insurance company to secure accurate and adequate data, other departments supply information. Inspectors make reports of pertinent information concerning hazardous occupations, as they find them, to the pay roll audit department. The claim department notifies the audit department of accidents that occur to employees under classifications not specified in the policy and also reports if an unusual number of claims occur in a classification where the estimated pay roll is small. In this way the auditor is afforded a cross-check upon the classifications presented in the insured's statement.

Malingering. One of the problems of workmen's compensation coverages is the employee who deliberately protracts his period of disability, by feigning incapacity after he has actually recovered. Malingering is not always easy to recognize, and experienced compensation adjusters meet it in a wide variety of forms. Sometimes there is actually no injury, but the employee contends that he has suffered an accident. Sometimes, there actually has been an accident with symptoms alleged that are not ordinarily associated with the reported injury. Again, the injured employee may deliberately aggravate a legitimate injury to postpone recovery, or after complete recovery he may pretend inability to work.[2]

The problem of malingering involves something more than defrauding an insurance carrier. Since all benefits under workmen's compensation laws are reflected in the rates, unjustified payments result in an undue burden upon industry. In cases in which experience rating applies, the loss is directly reflected in the employer's own rate.

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[2] The mental difficulties termed "hysteria" and "neurasthenia" in connection with industrial accidents give rise to particularly perplexing cases. Hysterics frequently believe themselves to be suffering from some injury, whereas the difficulty is purely mental. Neurasthenia is a mental difficulty and may be a mental injury, the outgrowth of worry or care, or it may be caused by a sudden injury or shock. Traumatic neurasthenia is one of the recurring problems of the compensation adjusters. To distinguish between the employee who is actually suffering from mental injury as the result of a shock and the malingerer is not always easy. In the mental case the employee actually cannot walk, move an arm, bend at the waist, or perform some simple task solely because of his ideas or mental state. Such a person is in need of mental treatment and is in no sense a malingerer. On the other hand, it is commonly believed that many cases of malingering slip by the most careful scrutiny under the diagnosis of traumatic neurasthenia.

Administration of the Law. While in some jurisdictions the administration of compensation law is left with the courts, the more usual method is to leave it with a special commission appointed for the purpose. When the courts have jurisdiction, cases are heard by a judge or a referee appointed by the judge. In the interests of simplification and to expedite the settlement of disputed points, legislatures have preferred the appointment of a commission. These commissions have been invested with varying powers, including general supervision over the administration of the compensation act, with power to make rules and regulations for the purpose of carrying out its provisions. Power is granted to prescribe forms and to arrange the procedure in such a manner as to effect a speedy and inexpensive disposition of proceedings.

Varying in degree with different states, commissions are given authority to appoint investigators to report on circumstances surrounding an industrial accident when they deem such an action necessary. When the facts are in dispute, the commission hears the evidence, and decisions are made in a summary manner. In the absence of fraud, the decision of the commission upon all questions of fact is final.

Compensation Insurance Carriers. Employers who operate in states having a compensation law are usually offered options as to how they shall guarantee the payment of claims. If an employer is able to furnish the state authorities with satisfactory proof of financial ability to pay compensation, nothing further is required, and the employer may set up his own fund or handle the matter as he pleases. All others are required to carry insurance.

Insurance may be provided either through a state fund or by stock corporation or mutual or reciprocal association authorized by the particular state to transact the business of workmen's compensation. Situations in the various states differ as to exact requirements. On one end of the scale there are state funds with a monopoly of the compensation business; other states permit only self-insurance in addition to the state fund; a third group has state funds in competition with private carriers; and another group of states entrusts the business of compensation insurance entirely to private carriers.

FOR REVIEW

1. X, an employer, is told that the workmen's compensation policy affords a coverage as broad as the act. He conducts a business at B Street. A new

location is shortly opened in another part of the city, and the employer expects to report the pay roll at this location at the time it is audited. Is he protected at the new location?

2. X operates a trucking business, and his experience has been most unfavorable. His workmen's compensation insurance carrier cancels the coverage. In an effort to get new insurance, the proprietor of the business makes several deliberate misstatements. Shortly afterward, because of negligence in the maintenance of a steam shovel, one man is killed and two others dangerously injured. Upon learning of the facts, the insurance company denies liability on the ground that the policy was obtained through deliberate misrepresentation of material facts. To whom may the injured employees and the legal representatives of the deceased employee appeal for damages?
3. B, while in the course of his employment, is seriously injured as the result of an automobile accident. He receives compensation payments for twenty-five weeks and then returns to his former employment. He is now advised to bring suit against the party responsible for his accident. May he do this?
4. Benzoil has a tendency to destroy white blood cells, causing a dangerous anemia. Benzoil is used in the rubber, tin can, and other important industries. Does the contracting of this disease constitute grounds for a compensable claim under the workmen's compensation laws?
5. Many industrial diseases are slow in developing and are difficult, if not impossible, to recognize in their earlier stages. Frequently it is only after several years that the effects of some diseases appear. X has changed his employment many times and has been working but a short time for B when he becomes seriously ill, and his trouble is diagnosed as lead poisoning. How, if at all, is his compensation for occupational disease apportioned among the insurance carriers of his employers since the inception of the disease?
6. Mrs. X is a salad maker in a restaurant and contracts an annoying skin affection caused by handling certain types of vegetables as a part of her work. Would you call this an occupational disease?
7. Are occupational diseases covered by the standard compensation policy without special endorsement?
8. X and Y are employed on a construction job. After an argument during working hours, X goes home, gets a shotgun, returns to the job, and shoots and seriously injures Y. In your opinion, would Y's injuries arise out of his employment, and is he therefore entitled to compensation?
9. J. B. operates a grocery store as an individual. He carries a workmen's compensation policy. Upon his death, what is the status of the executor and heirs as to coverage?
10. A, on his way to work, is entering the plant of the X manufacturing company where he is employed. He falls through an unguarded opening in the floor and is killed. It is contended that since employment had not actually begun, the accident was not covered by the workmen's compensation policy. What is your opinion?
11. X, the president of a manufacturing plant, delegated B, an employee, to work one day a week at his home doing gardening and odd jobs around the

premises. While building an arbor in X's garden B, in attempting to drive a nail, struck a glancing blow. He lost his eyesight as the nail struck him in the eye. Is B entitled to compensation for his injury and, if so, from whom?

12. B conducts a trucking business in his own name. If he should decide to incorporate, would it be necessary to secure a new compensation coverage, assuming the risk and the management remain exactly as before?
13. B has been using a chemical product in the course of his manufacturing operations. He discovers that poisonous gases escaping therefrom may prove fatal to the workers. Usually the symptoms of the chemical disease may not manifest themselves for many months after the disease has actually become seated. B, upon the discovery of the situation, discontinues the dangerous process. May he now safely discontinue to carry the occupational disease coverage?
14. In some states all occupational diseases are under the compensation act. In others the act includes certain specified diseases. In a third group there are no occupational diseases under the act. In the last two instances, if the insured has his policy endorsed to provide occupational coverage, is he as fully protected as when the occupational hazard is included in the compensation act?

15. A. B. filed suit against his employer for $60,000. He claimed that he had contracted silicosis because the paint plant in which he worked was not properly equipped with health-protecting devices. He was awarded $10,000. The award was followed by a flood of suits from other employees. How would the position of the employer be bettered if the disease were covered by the compensation act?
16. Indicate a difference that distinguishes claims made under a compensation policy from other casualty claims.
17. The X manufacturing company has several plants located in the state of Maine. As part of its policy to build up local goodwill, compensation insurance is placed on each plant locally. Is this good judgment?
18. The X department store is located near a state line. Chauffeurs, helpers, salesmen, messengers, and others frequently cross the line in the course of their business operations. To cover these employees properly, must a separate compensation policy be taken out?
19. A shoe manufacturing plant owns a tannery as a subsidiary. May the compensation policy of the tannery be combined with that of the parent company?
20. B purchases a business and upon checking the compensation risk finds that as a result of experience rating the business is penalized with an experience debit. May he have this changed immediately?
21. A large hospital carries compensation insurance but feels that it is in a position to render adequate medical aid in the event of an accident. May it receive a rate credit on this account?
22. State compensation laws are either compulsory or elective. Explain.
23. In a state in which occupational disease is not within the workmen's compensation law may an employer, entirely aside from any humanitarian element

that may enter the situation, disregard the question of occupational disease liability if he elects to accept the compensation act?

24. It has been held that sums paid by an employer into a fund for self-insurance to be used for the payment of compensation and other benefits under state compensation acts are not deductible from gross income as a business expense for income tax purposes. Explain the logic of this decision.
25. While sums set aside for self-insurance funds are not deductible as expenses in income tax returns actual payments made to injured employees may be deducted. From the point of view of a going concern is this more or less favorable than would be the case if contributions to the fund were allowed as deductions? Explain.
26. It has been stated that insurance companies make it difficult for physically handicapped employees to secure employment because of penalties in the compensation rate. Insurance companies deny this and point out that they do not in any way penalize the physically handicapped. Employers answer that, though no specific penalty is indicated, injuries reflect in their experience rating, and as a result they cannot afford to hire the physically handicapped. If you were an employer operating a large industrial plant would you feel safe in employing persons injured in industrial accidents or disabled veterans? Predicate your answer purely on the financial implications.

CHAPTER XXX

THEFT COVERAGES

AVAILABLE Coverages. Against theft a number of policy forms are written, each designed to cover a particular class of risk. The commonly written forms are: (*a*) residence insurance, (*b*) personal holdup insurance, (*c*) bank burglary insurance, (*d*) bank robbery insurance, (*e*) safe deposit box insurance, (*f*) mercantile safe insurance, (*g*) mercantile open stock insurance, (*h*) paymaster or messenger robbery insurance, (*i*) interior office burglary and robbery insurance, (*j*) storekeepers' burglary and robbery insurance, and (*k*) check alteration and forgery coverages.

The Theft Risk. The loss to property owners occasioned by theft is understood by few unless they have taken pains to investigate the matter. In the case of fire losses, particularly because they are spectacular in nature, the situation is considerably different. Virtually everyone who owns property provides insurance protection against loss by fire. Most property owners, however, are startled to know that the annual loss in the United States from check forgery alone is equal to the loss from fire. When other theft losses are added, the figures reach staggering proportions. Making use of modern inventions, criminals are constantly plotting to secure by illegal means money, securities, and valuables of others.

In a single year in the United States, according to figures of the Federal Bureau of Investigation, there have been 43,804 robberies, 274,134 burglaries, and 796,590 thefts. Each day there are 120 persons robbed, 749 homes or businesses burglarized, and 2,176 thefts. In 1944 there were 43.8 robberies per 100,000 persons. In 253 cities with a population of over 25,000 there was stolen $8,597,988 in money; the value of jewelry stolen amounted to $4,555,380; the value of furs $1,168,632; and the value of other clothing $2,493,608. There were 305 burglaries per 100,000 persons, and thefts not including automobiles averaged 919.5 per 100,000 for the year. It is obvious that the theft hazard is not to be neglected in the preparation of an adequate program.

Definitions. Crimes involving offenses against property, such as robbery, burglary, and larceny, are not always defined identically in

the statutes of different jurisdictions. To eliminate any element of uncertainty, policies covering theft losses provide a definition of the hazard to be covered. Briefly, "robbery" consists of the carrying-away of the personal property of another from his person or in his presence by violence or putting him in fear. "Burglary" is the breaking and entering of the dwelling of another at night with the intent to commit a felony. This is generally broadened to include theft losses occasioned by person or persons making felonious entry by actual force or violence. "Theft" is the stealing or taking of another's goods. The legal term for theft as used in insurance policies is "larceny," and in the insurance contract both terms are used interchangeably. "Larceny" is the taking- and carrying-away of the personal goods of another with a felonious attempt to steal. Larceny losses would include thefts by sneak thieves, servants, tradesmen, mechanics, or others having access to the premises of the insured. Such losses, of course, would not fall within the category of burglaries and would not be covered by a policy insuring the burglary risk only.

Residence Burglary Insurance. The earliest attempts to insure householders against theft losses provided insurance only against loss by burglary. Policies are now written furnishing a broad coverage and covering in addition to burglary the hazards of robbery, theft, and larceny. The form covering the burglary hazard only is still written; and a policy covering burglary, theft, and larceny without the robbery coverage is obtainable. Since so many residence losses are due to sneak thieves and others who enter the premises without the use of force, the broad coverage is preferable because there is less liability of misunderstanding. For those willing to risk larceny losses, the restricted form is available at a lower rate.

The broad form covering residence burglary, robbery, theft, and larceny is known as a "residence and outside theft policy" and provides two major types of coverage: (1) theft from premises or depository and (2) theft away from the premises. The policy covers the hazards of burglary, robbery, theft, larceny, and, of great importance, mysterious disappearance. Coverage includes the property of the insured, members of his family, relatives, guests, residence employees, and other permanent members of the household. The property is covered not only in the residence or apartment of the insured, and on the porches, grounds, in the garage or other outbuildings but

also while in any bank, trust or safe deposit company, public warehouse, or occupied dwelling not owned, occupied, or rented by the insured where the property is placed for safekeeping located within the United States, Canada, or Newfoundland. The policy also covers damage caused by burglars, robbers, and thieves to the insured property or to the interior of the building occupied by the insured, or loss or damage caused by vandalism or malicious mischief.

When the property is away from the premises and the premises coverage provides at least $1,000 coverage exclusive of specific insurance, it is covered for at least that amount against the hazards of burglary, robbery, theft, larceny, mysterious disappearance, vandalism, and malicious mischief. This covers property temporarily located in any hotel, club, dormitory, cottage, or other dwelling. Thefts of personal property stolen from a private automobile, taxi, or bus are covered, as well as property stolen from trains, boats, checkrooms, and locker rooms.

Separate amounts of insurance are, in the ordinary course, placed upon jewelry, watches, gems, and the like, and another amount upon household goods and personal property generally. Any particularly valuable item may be specifically insured.

Upon the payment of an additional premium the residence policy may be written to cover premises when occupied for certain designated business or professional purposes. Among the occupancies permitted are dressmakers, milliners, physicians, surgeons, and dentists. Unlike other burglary policies covering "personal property," this policy covers "all property." This brings within the scope of the protection real property as well as personal property, to the end that if parts of the real estate are stolen or damaged through an attempted theft, there is a loss under the policy. The definition of "theft" which provides that "mysterious disappearance shall be presumed to be due to theft" affords an extremely liberal coverage. Recently some companies have eliminated the mysterious disappearance feature as a "claim breeder." The clause, it is contended, is broader than necessary to be useful, and the claims that are presented are costly. Frequently there is grave doubt as to whether or not the claims are actually the outgrowth of theft losses. The companies do not contemplate covering losses caused by carelessness.

The outside theft is a very broad form and provides coverage of the property wherever it may be, and whether or not a person is with

it. The coverage, however, is not so broad as that provided in the personal effects floater, in that other damage to the property not caused by theft, attempted theft, vandalism, or malicious mischief is not covered. It is, of course, apparent that the policy does not cover fire, water damage, windstorm, aircraft, and other like perils. This policy, however, taken together with fire insurance and the extended cover endorsement, provides a broad and comprehensive form of insurance protection. The combination was at one time widely used as a substitute for the personal property floater in those areas where no exception to the definition of marine insurance had been made to permit the marine coverage on household effects.

There are certain limitations such, for example, as a limit of $100 on money and $500 on war savings stamps. Boats are covered in full while on the premises but limited where away from the premises to $500. Properties excluded include aircraft, automobiles, trailers, motorcycles, or their equipment. Samples are excluded; but other property pertaining to the business or profession of the insured is covered while on the premises but excluded while off the premises. Animals and birds are not covered, nor is property owned by boarders not related to the insured. The exclusions are few, and the policy is broad and comprehensive.

Upon knowledge of any loss or damage the insured is required to give immediate notice to the company, telegraph sometimes being specified as the means to be used in order to insure speed. The insured must also give immediate notice to the police or other peace authorities having jurisdiction. A proof of loss must be furnished to the home office of the company within sixty days from the discovery of the loss. Payments made by the company reduce the amount of insurance. The company may repair any damage to the property or replace any stolen or damaged property with property of similar quality and value or make payment in money, as it may elect. If property for which the insured has been indemnified is recovered or returned, the insured must either forward the article to the company or return the amount of the loss paid by the company.

Messenger and Interior Robbery. Stores, offices, and other places of business are not immune from robbery during business hours, and messengers carrying money and valuables are held up and robbed on the city streets. Interior holdup insurance, covering office and store robbery risks, and outside holdup insurance, covering the risk of

messenger robbery, may be written in a single policy, or either coverage may be written separately.

The interior holdup policy covers loss or damage to the insured property through robbery or attempted robbery and loss or damage to furniture, fixtures, and other property, plate glass excepted. The coverage is effective on a twenty-four hour basis and furnishes protection only within the insured's premises. Loss or damage to merchandise stolen from a show window by a person who has broken the glass from the outside, or by his accomplice, is covered while the premises are regularly open for business.

Kidnapping is sometimes resorted to by robbers to hold the owner of a property or his employee, later forcing the person detained to open the premises or supply information, keys, or other means of admission. Kidnapping usually occurs off the premises. The policy provides protection to the insured if a loss is attributed to the kidnapping of a custodian after the premises are closed for business.

The premium for interior robbery, as in other robbery coverages, is dependent upon the territory in which the risk is located, the number of persons on duty within the insured's premises, the kind of business, the protective measures, and the kind of property.

When both interior and messenger robbery insurance are carried, losses are covered whether they occur inside the building or outside of it. Interior robbery, if written without messenger coverage, does not cover outside the building. In certain types of risk this coverage is desirable when the messenger policy is unnecessary. In cases in which custodians meet customers outside the building, as at filling stations and other roadside places of business, upon the payment of an additional premium equal to 50 per cent of the charge for interior robbery, the coverage may be extended to include the ground immediately surrounding the store, office, or structure used by the insured in serving his customers.

Again, there is a type of risk in which it is the usual practice for the manager or owner to take the cash home that accumulates after banking hours and up to closing time. This is usually the custom if there is lacking safe means for leaving the cash on the premises of the business. Where this is the custom, burglary, robbery, theft, and larceny coverage in the home of the custodian may be endorsed to the messenger or interior robbery policy. This extended coverage may

be limited to burglary only if this more limited protection is desirable.

Messenger robbery insurance covers the insured for robbery losses if the robbery or attempted robbery takes place outside the premises of the insured. Factors affecting the premium on messenger robbery are the territory, the number of guards accompanying the custodian, the nature of the property covered, and any other protective measures approved as tending to reduce the hazard.

Credits on the rate under the messenger robbery form are allowed when certain designated precautions are taken. These are: (1) the use of a private conveyance or armored car of bullet-proof steel; (2) the use of a locked messenger safe or chest, or satchel or wallet lined with steel or wire mesh and attached by chain or wire strap to the custodian or vehicle conveying the funds; (3) the use of a route limited to the interior of the building containing the premises of the insured. There is also a rate credit when the coverage is limited to securities only.

Paymaster Robbery Insurance. Many concerns pay their employees in cash and in the course of effecting the transaction transfer large sums of money from point to point. The policy to cover this is similar to the messenger robbery policy but contains features to fit the particular needs of pay roll risks.

The policy provides day and night protection for the insured from loss by robbery from a custodian outside the insured's premises of money or checks held solely for pay roll purposes. It covers as well, outside the premises, for an amount not exceeding 10 per cent of the amount of the insurance for loss of, or damage to, money and securities not intended solely for pay roll purposes if the loss is the consequence of a robbery or attempted robbery from a custodian. Differing from the messenger policy, this form covers inside the insured's premises for loss of, or damage to, money or checks intended for payroll purposes and extends also to cover damage to the premises, furniture, fixtures or other property, plate glass excepted, within the control of a custodian provided the custodian at the time is engaged in his regular duties in handling pay roll funds. Employees of the insured are protected, while in the premises of the employer, against loss of money or checks in their possession if such loss is the outgrowth of a robbery on the day or night on which they were paid. Pay roll

funds taken by robbery from a safe do not come within the protection of the policy. Losses to pay roll funds, after the premises are closed for business, are covered if attributable to the kidnapping of a custodian.

If the paymaster takes funds to his home during the night, the same type of extended coverage for such funds may be provided as is provided under the messenger and interior policy in like situations.

Bank Burglary and Robbery Insurance. Since the greatest concentration of money and securities is in banks and financial institutions, it is natural that these institutions should early have been a target for burglary and holdup. The risk was readily apparent; and because of this, bank burglary and robbery insurance was one of the first forms of this type of coverage to be written. The standard form in use has passed through a considerable period of development. In co-operation with the American Bankers Association a form has been devised which furnishes adequate and satisfactory protection to banking institutions. The form is known as the "American Bankers Association Standard Form Bank Burglary and Robbery Policy." The policy provides four distinct coverages: (1) burglary, (2) robbery, (3) property damage caused either by burglary or robbery, and (4) property damage caused by vandalism or malicious mischief. Under the burglary policy, indemnity is provided for loss of money or securities by burglary of safes or vaults. The robbery coverage provides indemnity for loss of money or securities by robbery from within any part of the premises of the insured. The property damage feature provides indemnity for loss sustained as the result of damage to money and securities or to the premises, furniture, fixtures, vaults, safes, money boxes, or the like when caused by burglary or robbery or any attempt thereat. Vandalism and malicious mischief coverage takes within its scope any intentional wrongful injury to money or securities or the fixtures or premises of the insured. It is to be noted that in the property damage coverages loss caused either by burglary, robbery, vandalism or malicious mischief, or fire damage to money and securities is not excluded. This is so because damage to money and securities is not covered under the fire policy. However, fire losses to premises, furniture, fixtures, and the like are never covered under the bank burglary and robbery insurance policy regardless of how the fire loss is caused.

As in other burglary coverages, in order to establish the liability of the insuring company one must prove that entry was made by force. This is to be demonstrated by the presence of marks caused by the use of tools, explosives, electricity, gas, or other chemicals. It follows, therefore, that money, securities, and other property taken from safes while open are not covered. If the vault is forced open and a money box or safe carried away and opened off the premises, the burglary coverage is effective. The first section of the policy provides indemnity for loss of money or securities through robbery within the premises occupied exclusively by the insured, his officers, or employees.[1] Burglary and robbery, together with the attendant property damage, may be covered under a single policy. It is possible, however, to cover losses from either burglary or robbery with attendant property damage. When burglary and robbery are carried together, a separate limit of liability is designated in the policy for each hazard, and property damage losses from either hazard are subject to the policy limit designated for that particular hazard.

The policy provides that there is no liability on the part of the company for loss or damage to securities unless the insured takes active steps and exercises due diligence in preventing negotiation, sale, or retirement. It is also mandatory upon an insured to keep adequate records to the end that the amount of any loss can be accurately determined. There is no loss under a burglary policy if the vault is left unlocked or if it is opened through a manipulation of the combination. The policy does not cover transit risks or property stolen away from the premises of the bank. Neither are the contents of safe-deposit boxes covered unless the loss involves the contents of a specified vault for which a record is maintained. Unobserved sneak thief losses are not covered, nor are losses due to mysterious disappearance. Losses, the outgrowth of dishonest, fraudulent, or crim-

[1] The policy defines the term "robbery" as follows: "Robbery, as used in this policy, shall mean a felonious and forcible taking of property: (1) by violence inflicted upon the person or persons having the actual care and custody of the property; (2) by putting such person or persons in fear of violence; or (3) by an overt felonious act committed in the presence of such person or persons and of which such person or persons were actually cognizant." Money is defined as "currency, coin, bank notes (signed or unsigned), bullion, uncancelled United States postage and revenue stamps in current use, war savings certificates, stamps not attached to registered certificates, and thrift stamps." The policy provides that the term "securities" shall mean "all negotiable or non-negotiable instruments, documents, or contracts representing money or other property."

inal acts of employees of the bank, are excluded except in the instances when an employee is an active participant in a burglary or robbery.

Bank burglary and robbery rates are computed separately. Burglary coverage is based upon a classification of safes and vaults. A rate is quoted, and the premium is determined by multiplying the rate by the thousands of dollars of insurance to be carried. From this sum certain deductions are allowable. Discounts are based upon: (*a*) the territory, (*b*) the population of the town or city, (*c*) the use of an approved alarm system, (*d*) watchman service, (*e*) the division of insurance so that not more than 50 or 75 per cent applies to any one safe or vault at any one place, and (*f*) the limitation of policy to cover securities only or securities and subsidiary coin only. A discount is allowed for the use of certain designated locks and for insurance if written for a term.

Bank robbery rates are based upon a territorial classification. Discounts are allowed for (*a*) daytime guard or watchman, (*b*) daytime burglar alarm, and (*c*) limitation of insurance to securities, silver, and subsidiary coin. Banks in cities where the population is 1,000,000 or more and where twenty-five or more persons are employed are allowed a special discount on the rate.

Mercantile Open Stock Burglary Insurance. This is one of the most important coverages in the crime group. The owner of money, securities, jewels, jewelry, bullion, and other like valuables is conscious of the risk of loss at the hands of thieves. Certain classes of merchandise, such as silks, satins, furs, and laces, run to great values. However, merchants and manufacturers frequently suffer losses of readily salable merchandise when unusual value is not a conspicuous feature. Goods are stolen from lofts, warehouses, show windows, manufacturing plants, as well as from stores where the goods are displayed for sale. The risk of loss of merchandise, whether it is actually carried away by a burglar or damaged by an attempted burglary, may be covered by the mercantile open stock burglary policy. If the merchandise covered is stored in a public storage warehouse, the policy may be extended to cover, in addition to burglary, loss by theft and larceny. Pilferage from packages may be covered, but if this risk is excluded there is a very substantial saving in the rate. This type of cover is most carefully underwritten and many companies require home office authorization prior to the binding of a risk.

The contract undertakes to indemnify the insured for loss of the insured property caused by burglary while the premises are not open for business. The policy covers all merchandise in the insured premises as well as furniture, fixtures, and equipment, but not money and securities. To be within the protection afforded by the policy, the property must be on the premises of the insured as defined in the contract. Show windows or show cases not opening directly into the interior of the premises, as well as public entrances, halls, and stairways, are not within the coverage of the policy. This risk, however, may be specifically insured. The term "premises" is defined to mean only the interior of that part of the building described in the application as occupied solely by the insured in conducting his business.

Under the terms of the policy there is no coverage for loss or damage to furs or articles made entirely or principally of fur caused by burglary of such merchandise from within any show window in the premises after glass has been broken from the outside. The risk is insurable, but if this class of merchandise is to be covered in show windows, the coverage must be supplied by means of a separate endorsement attached to the policy, for which an additional premium is charged. The policy further provides a limit of $50 for loss or damage to any one article of jewelry. This limit may be increased upon the payment of an additional premium. Property held as a pledge or as collateral for a loan is insured to the extent of the amount advanced, plus accrued interest at the legal rate to the time of the loss, but is in any case subject to the limit set for jewelry. Under its terms the policy excludes liability if the insured, an associate, or an employee is connected with the burglary either as a principal or as an accessory. Losses caused or contributed to by fire, or occurring during a fire in the building in which the premises are located, are excluded, as are losses to plate glass. To prove loss, the insured must be able to present an adequate set of books, and the company's liability is limited by the actual cash value of the merchandise at the time of loss or damage. In no event does this liability exceed the actual cost of repairing or replacing the property when damaged. If there is any material change in the nature of the risk, the policy does not extend to cover such a change.

In connection with the mercantile open-stock burglary policy there is a new application of coinsurance. The rating manual provides for the separation of various types of businesses into trade classi-

fication for rating purposes. There are four territorial divisions, in each of which the coinsurance requirements differ. In Territory I the coinsurance requirement is 80 per cent; in Territory II, 60 per cent; in Territory III, 50 per cent; and in Territory IV, 40 per cent. Opposite each trade classification in the manual, an amount is designated as the coinsurance limit. The coinsurance limit has the effect of nullifying the coinsurance feature to the extent that if the insured carries the amount stipulated as the coinsurance limit he will in no case be a coinsurer.[2]

Mercantile Safe Policy. Money, securities, and merchandise of unusual value are protected from loss, so far as it is possible to do this, by means of strongboxes, safes, and vaults. While the protection afforded valuables by an adequate safe or vault is not to be underestimated, some idea of the risk in placing full dependence upon the security thus offered is at once apparent when it is realized that, given time and equipment, a skilled burglar can open any safe or vault ever made. The risk is covered by the mercantile safe policy. The coverage is not limited to strictly mercantile risks but may be issued to any person or organization owning a safe or vault.

Under this form, money is defined as "currency, coins, bank notes, and bullion." Securities, as defined in the policy, include all negotiable or nonnegotiable instruments, such as checks, drafts, bonds, and stock certificates or contracts representing either money or other property. Included in the category are revenue and other stamps in current use. In addition to covering money and securities in the safe, the policy covers "other property." Other property of any kind kept by the insured in the safe is covered; and personal property, such as jewelry owned by the insured or employees, is covered provided always that there is a sufficiently adequate record to permit a determination of the amount of the loss or damage in the event of a burglary.

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[2] The operation of the coinsurance clause under the foregoing condition may be illustrated by the following example:

Value of inventory	$60,000
Coinsurance percentage for Territory II, 60 per cent	36,000
Coinsurance limit for Territory II	30,000

To comply with the coinsurance clause, the insured must carry 60 per cent of the value of the inventory; but since the coinsurance limit is less than 60 per cent of the value of the inventory, the coinsurance requirement is fully satisfied if $30,000 of insurance is carried. If less than the coinsurance limit is carried, losses are paid in the proportion that the amount of insurance carried bears to the coinsurance limit.

As in other burglary policies, the contract extends to cover damage to property, with the exception of fire, caused by burglary of the insured's safe or any attempt at a burglary. Property damage coverage extends to the insured's safe or vault together with the insured's property within. It also covers property damage to furniture, equipment, and merchandise in the premises, but not in the safe or vault if the loss is attributable to a burglary. If the insured is liable for damages to the premises, this coverage also comes within the scope of the contract. Plate glass is not within the scope of the property damage coverage. The property damage loss to furniture, fixtures, or merchandise is not covered, however, unless the insured's safe has been entered by force or an attempt at such entry actually made.

In order to establish a loss under a mercantile safe policy, it must be shown that a robbery was actually effected or attempted. Entry to the safe or vault must have been effected by the use of tools, explosives, electricity, gas, or other chemicals upon the exterior of the safe, at a time when it was properly closed and locked by at least one combination or time lock. Evidence of the force used must appear on the exterior of the safe. An adequate set of books must be maintained from which the value of the lost or damaged items can be determined.

Rates for mercantile safe insurance are quoted per thousands of insurance carried and depend upon the following features: (1) type of safe, (2) territory, (3) class of business, and (4) property covered. Safes are classified as (1) fireproof, (2) semi-burglarproof, (3) burglarproof, and (4) double burglarproof.

Under the safe burglary policy the company is not liable for loss or damage to manuscripts, records, or accounts; nor is it liable for loss to any property owned by the United States government or held by the assured as a postmaster. The exclusion with reference to the government property is based upon a federal regulation which permits the government to reimburse the postmaster for burglary losses up to $10,000, and the amount may be in excess of $10,000 in the event Congress approves. Losses occurring while combination on time lock, burglary alarm, vault, or private watchman service warranted in policy declarations is not maintained are excluded, as are losses effected by opening the door of the safe, vault, or chest by manipulation of the lock.

Losses attributed to manipulation of locks are regarded as theft

losses but not in the burglary category. If the manipulation is performed by an employee of the insured, the protection is available through a fidelity bond coverage. Kidnapping coverage is not available in connection with safe burglary insurance. If an employee of the insured is forced to return to the premises under threat of violence and opens a safe or vault, the loss is not regarded as a burglary loss. If the insured feels that this hazard should be covered, he may obtain protection through providing inside robbery insurance with the kidnapping coverage included.

Discounts are allowed for features that tend to minimize the risk, such as a private watchman, safes equipped with an approved relocking system, premises protected with an approved burglar alarm system, and safes or vaults equipped with certified tear-gas systems. Discounts are allowed when there is more than one safe in a single location. If part of the insurance covers "securities only," "merchandise only," or "securities and merchandise only," a discount of 25 per cent is allowed for that part of the insurance that so covers. If the insurance covers loss to property only, a 50 per cent discount from the manual rate is allowed.

Storekeepers' Burglary and Robbery Insurance. This form is designed to meet the needs of the small storekeeper and merchant and provides at reasonable cost a blanket burglary and robbery coverage. Until this form was made available, the small merchant found it difficult to secure adequate burglary and robbery insurance protection, owing to the fact that rules as to protective devices, coinsurance requirements, and minimum premiums were drawn with the larger concerns in mind.[3]

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[3] The storekeepers' form in a single policy covers the insured against loss of money, securities, and merchandise, together with damage to property. The policy covers not only the property of the insured but also property held by him as bailee, in trust or on commission, or as collateral, or in any other capacity where he is liable to the owner for loss or damage. The coverage is provided under seven headings, with $250 insurance applying to each as follows:

1. Office and store robbery covers loss of any securities and merchandise by robbery from a custodian within the premises. Only one custodian is required, and the coverage is for a period of 24 hours.

2. Messenger robbery covers loss by robbery from a custodian outside the premises anywhere within the United States or Canada.

3. Kidnapping coverage protects the insured against loss in case a custodian while outside the premises and under threat of violence shall be compelled to provide means of egress to the premises. The loss must be occasioned by theft within the premises before the premises have been opened for the next business day.

4. Safe burglary coverage provides protection against loss of any securities and

The company is not liable for burglary and robbery losses if the loss or damage occurs during a fire in the building or is in any way contributed to by a fire. The policy further excludes losses of property by abstraction from a show window by a person or persons who break the glass from the outside, or by their accomplices if the theft is committed while the premises are open for business. In the case of jewelry, gems (precious or semiprecious), watches, and the like, the company's liability is limited to $50. In the case of articles held as a pledge or collateral for a loan, the company assumes liability only for the amount advanced, plus legal interest to the date of the loss, but the liability in no case is to exceed the $50 limit.

Contrary to the usual provisions under the burglary and robbery coverage, there is no reduction in the coverage in the event of the payment of a loss, but the full amount of $250 applying to each of the coverages remains in force during the policy term.

Office Burglary and Robbery Insurance. A policy similar to the storekeepers' policy is written to provide a burglary and robbery coverage for offices. The coverage, provided in the amount of $250,[4] is designed to provide a burglary and robbery protection for tenants

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merchandise from within a safe or vault in the premises. This coverage is effective when all doors of the safe or vault are locked by at least one combination or time lock. To support a claim, entry to the safe must have been made by force or violence, of which there must be evidence in the form of visible marks.

5. Felonious abstraction coverage provides indemnity for loss of money and securities from a night depository of a bank. The coverage also extends to loss of money or securities from the house or apartment, the residence of a custodian. The theft must be committed by a person making felonious entry by force, of which there is visible evidence.

6. Mercantile open stock burglary coverage provides indemnity for loss of merchandise, furniture, fixtures, and equipment. A limit of $50 is placed upon the liability of the company as the aggregate for any loss of cigars, cigarettes, tobacco, fountain pens, alcohol, wines, liquors, and narcotics, and as in other burglary coverages the theft must have been made by a person or persons making a felonious entry by force and violence, of which there must be visible evidence.

7. Property damage is covered where the loss is occasioned by a burglary or robbery actually committed or attempted. Building, furniture, fixtures, and equipment are covered under this section, provided the insured is the owner of the property or responsible for the damage.

[4] The $250 insurance applies to six separate coverages as follows: (1) inside holdup, (2) outside holdup, (3) safe burglary, (4) office burglary, (5) kidnapping coverage, and (6) property damage. Upon payment of an additional premium, one may buy coverage within the limits of the policy for gold, silver, platinum, and other like materials used in the office of a dentist.

When coverage to the extent of $250 is not sufficient, more than one policy in both the storekeepers' and the office burglary and robbery forms may be brought to cover a single risk. The amount applying to each division under a single policy may not be varied.

in office buildings. It protects the insured against loss of money, securities, and other property but excludes merchandise.

The class of risk for which the office form is designed includes accountants, architects, attorneys, auditors, insurance officers, brokers, contractors, dentists, doctors, and the like. Specifically excluded are bankers, auctioneers, coal dealers, garage keepers, ticket office clerks, theater owners, loan groups, and similar risks. Businesses in which merchandise and other property are held for sale or manufacture, cleaning, repairing, pressing, or storing may not be covered under this form.

Safe-Deposit Boxes Insurance. In the absence of negligence it has been generally held that there is no liability on the part of a bank for loss to the contents of rented safe deposit boxes. In those cases in which the decisions of the courts have held the banks liable, the question has been presented as to whether the bank had furnished the holders of safe deposit boxes the same protection as the bank gave its own property. With the question of liability to this extent uncertain, the owners of securities or other valuables in rented boxes are interested in providing insurance against loss of the contents. Banks are likewise interested in providing the same insurance protection for property in boxes as they provide for their own property. Two forms of burglary and robbery policies are offered: (1) to the bank that wishes to insure all the boxes, and (2) to the individual who wishes to insure his own box only.

Insurance written for the bank is available in two forms: (*a*) a blanket safe deposit box burglary and robbery form, and (*b*) a safe depository liability form. The blanket burglary and robbery policy covers against the risks of loss of property in customers' safe deposit boxes through burglary or robbery. The policy also covers damage or destruction caused by these hazards or attempts thereat, as well as that caused by vandalism or malicious mischief. All property is covered except money in the customers' safe deposit boxes. Damage to the premises, safes, vaults, and other furnishings of the insured institution are covered under this form as under other burglary and robbery forms. The measure of loss is the pecuniary loss. This precludes making a claim based upon a sentimental value.

Policies in this category limit the liability for loss from any one box to 10 per cent of the total amount of insurance. Damage to the premises, equipment, or furnishings of the lending institution is paid

for first, and the balance of the insurance is prorated among the boxes, subject to the aforementioned 10 per cent limitation.

The second form, the safe depository liability policy covers only the legal liability of the insured for loss to the property of a lessee. Under this policy there are no restrictions as to how the loss or damage must occur, nor is there any limitation as to the amount applicable to each box. However, the policy is in the nature of a defense policy, and the insurance company is liable to pay only in the event that it can be established that the insured is obligated to pay the amount of the claim because of liability imposed by law. This is in contrast to the burglary and robbery form, which does not require that the bank be legally liable in order that the company be liable under the policy. The weakness in the liability policy is found in the fact that it does not protect the lessee. Unless liability can be established the bank may suffer loss of goodwill through its failure to provide insurance protection for the boxes.

The form issued to individual lessees undertakes to indemnify the insured for loss or damage to his own property or to property for which he is liable. The burglary coverage is effective while such property is contained in leased or rented boxes in a designated vault. The robbery feature provides coverage inside the premises of the bank while at least one officer or employee of the bank is on the premises.

The most recent development in this classification is an all-risk securities safe deposit form. This form is issued to lessees and provides protection against all risks of loss, damage, or destruction caused by burglary and robbery only, and only securities are covered. In addition, the policy provides insurance against any form of theft or larceny and includes within its protection the unexplainable disappearance or misplacement of securities. Losses originating through dishonesty or the criminal act of an agent of the insured would fall in the fidelity category and are not covered, although the policy does extend to cover losses occasioned by carelessness or negligence. This form is particularly desirable for the use of institutions that have large security holdings.

Church Burglary and Robbery Form. This is a comprehensive coverage written for churches only. The protection afforded is very broad, covering burglary, robbery, theft, and larceny. Property coverage not only includes money, securities, and such valuable items

as chalices, ciboria, and other sacred vessels but also extends to other furnishings used in a church edifice, including musical instruments and vestments.

The burglary, robbery, theft, and larceny features of the coverage apply both to the church structure itself and to the parish house, rectory, parsonage, or other residence occupied by the administrative officer of the church. If the church owns or leases other buildings used in connection with its activities, the coverage extends to these properties. The robbery coverage includes holdup and protects the insured against loss of church property, including money or securities outside its buildings. While the policy is usually written as a blanket coverage, it is sometimes advisable to insure special valuables specifically.

Money or securities stolen from "poor boxes" constitute the only exclusion under the policy. In contrast to the usual coverage under burglary and robbery policies, under this form there is no exclusion of losses due to the collusion of employees of the insured, nor is there exclusion of burglary or robbery losses caused by them.

Fraternal Protective Policy. This form insures against loss of money or personal property belonging to a fraternal order up to $200. Coverage in this amount is provided against the robbery of an officer as the result of a holdup within 20 miles of the premises of the order. Safe burglary protection is provided up to $200. Coverage for check alterations and forgery is provided up to $100, with a limit of $50 on any one check. A feature distinguishing this policy from the usual burglary and robbery coverage partakes of the nature of a bond. The bond feature indemnifies the lodge against loss up to $300 through larceny or embezzlement of money or property by any of the officers of the order.

Check Alteration and Forgery. Check alteration and forgery policies are designed to cover two classes of risk. The first of these insures banks under either a limited or a blanket coverage; the second is designed for the protection of depositors and is written for any individual, firm, or corporation other than a bank.[5]

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[5] At common law, according to the definition of Blackstone, forgery is "the fraudulent making or alteration of any writing to the prejudice of another's rights." An English case enlarges this definition to read: "Every instrument which purports to be what it is not, whether executed by a person who is not the person purporting to execute it, or bearing a date which is not the true date, is a forgery." To constitute forgery there must be (*a*) a false making of some instrument, (*b*) an instrument, as made, apparently

Under the form issued to individuals, firms, and corporations, there are two distinct classes of coverage. The first class covers outgoing items and provides insurance against loss for the forgery or alterations of checks, drafts, or other instruments issued by the insured or claimed to have been issued by him. The second class covers those items received by the insured, referred to as "incoming items." The policy issued to banks and trust companies is written under two forms. To these may be added the forgery protection afforded under the bankers' blanket bond. The bankers' policy is written under (*a*) a limited form, and (*b*) a blanket form.

Securities forms are written to provide indemnity to the insured for loss occasioned by the forgery, counterfeiting, or altering of securities. The coverages afforded under the securities form are broad and flexible and may be adapted to meet the particular needs of any specific case.

Depositors' and/or Commercial Forgery Policy. Until recently there were two forms of forgery policies in common use: (1) the depositors' form, which covered outgoing items only, and (2) the commercial form, which contained two sections, section A, identical with the insuring clause of the depositors' form, and section B, which covered incoming items.

The depositors' and/or commercial form now in use is broader in its terms than the older policies and is used to furnish the same classes of coverage. In cases in which the old depositors' form covering outgoing items was used, the present form can be written insuring under section A alone. Insurance such as was granted under the commercial form is obtainable by covering under both section A and section B. If coverage is desired only on paper received by the insured, insurance may be granted under section B alone, though most com-

capable of defrauding, and (*c*) an intent to defraud. A material alteration amounts to the false making of an instrument.

From the foregoing it is apparent that any writing may be the subject of forgery. Forgery and check alteration policies are limited to forgeries in which the writing is an instrument capable of negotiation, such as a check, draft, note, bill of exchange, trade acceptance, order for savings withdrawal, or the like.

At common law, if the instrument as made is apparently of legal efficiency, a material alteration made with an intent to defraud is forgery. Forgery policies do not insure blanket against all losses from forgery, but specify in the insuring clause the risks assumed. As a result, in insurance terminology two terms have come into common use. "Forgery" is used in connection with counterfeit or false signatures or endorsements. The term, "check alteration," is used when reference is made to alterations such as change of date, amount, number of the check, name of the payee or other change in the body of the check made with an intent to defraud.

panies are reluctant to issue policies under section B without coverage under section A.

Coverage of Insured's Paper Only. This is the form most commonly used and serves the requirements of the insured when the hazard from incoming items is not regarded as great. Therefore, checks, drafts, or other instruments accepted by the insured that may be the occasion of loss because of alteration or forgery are not insured under this form. On the other hand, the banks in which the insured maintains his accounts enjoy the same protection as the insured with respect to forged instruments of the insured. This protection to the bank has the effect of eliminating the question of liability between the bank and the insured.

The insurance covers whether the forged signature purports to be that of the insured in the capacity of the drawer of a draft, check, or bill of exchange, the maker of a note, or the acceptor of a draft, bill of exchange, or trade acceptance. The coverage affords protection against forgery of the endorsement of any payee or other person upon a check or draft drawn by the insured upon his bank.

Combined Coverage. Retail establishments that in the ordinary course of business take large numbers of checks find the danger of losses from forgery a very real one. Business establishments where the incoming hazard is regarded as important find adequate insurance protection through coverage under both sections A and B of the policy.

The insurance provided under section B covers losses caused by the taking by the insured of forged or altered instruments in the course of business operations in exchange for merchandise or services. It follows, therefore, that checks cashed by the insured as an accommodation are not within the scope of the coverage. Cash may be given as change when a check is paid whose face value is in excess of the price charged for the article or service without affecting the coverage. The coverage does not extend to indemnify the insured for losses when the check is drawn on an account with insufficient funds, or when the check is returned marked "no account." Such losses are not regarded as due to forgery or alteration and are to be guarded against by the ordinary precautions of those in charge of credits.

Under section B the insured is required to carry 25 per cent of every loss. This is due to a provision in the policy limiting the amount of the insurance carrier's liability for any one instrument to

75 per cent of the insured's pecuniary interest in the instrument. This is to be determined by the amount paid for property sold and delivered, or for services rendered, fixed at the time of the transaction, to which may be added any sums delivered against the instrument in question in excess of the amount paid for goods or services. The policy does not cover losses which are the outgrowth of receiving that class of instrument known as a "traveler's check."

Private Bankers' Form. The depositors' and/or commercial form is issued to insure private bankers and stock brokers. A special rate is promulgated to apply to risks of this class, and section B of the policy is endorsed to provide 100 per cent coverage instead of 75 per cent, as the policy is usually written. Instruments insured under section B are also covered when accepted by the banker or broker as collateral.

Bankers' Limited Forgery Policy. Of the two policy forms issued to banks and trust companies, the bankers' limited forgery policy is the most widely used, though the coverage afforded is more limited than that obtainable under other coverages. It is particularly attractive to those who deem the coverage satisfactory, because its cost is moderate.

The form provides for the banking institution essentially the same protection upon its own paper, such as checks and drafts, savings account withdrawal orders, certificates of deposit, and the like, as is afforded individuals and firms under section A of the commercial policy. The policy protects the insured banks and the interests of other banks (but not individual depositors) from forgery or alteration losses.

Under the terms of the insuring clause, the insuring company agrees to indemnify the insured against direct loss, not exceeding the limits set in the face of the policy, which may be sustained through the payment during the policy term of any instrument or instruments as defined in the policy which shall have been raised or altered in any other respect or upon which the name of the drawer, maker, acceptor, or endorser thereof shall have been forged.

Bankers' Blanket Forgery. This policy is very broad and is designed primarily for commercial banks. For this reason savings accounts are not included in the coverage, though upon the payment of an additional premium the coverage on savings accounts may be added by endorsement. The protection covers not only forgery of

the banks' own paper, but also extends to cover checks, drafts, and other instruments received by the banks. Savings withdrawal orders, covered under the bankers' limited forgery form, are not covered under this bankers' blanket forgery form unless the policy is extended by endorsement to include savings accounts.

The coverage is broader than under the limited policy, in that it extends to cover losses through forged depositors' checks drawn upon the insured, checks and drafts drawn upon any bank bearing the forged signature as endorser of any depositor of the insured, or through payment upon notes, trade acceptances, or other designated negotiable paper payable at the bank of the insured.

Forged Securities Policy. This coverage is provided for banks, brokerage houses, corporations, or other business organizations whose business is concerned largely with issuing securities or with investing or dealing in them.

The coverage offered under the forged securities policy is very broad. Two forms are in general use: (*a*) standard form number 3, and (*b*) standard form number 4. The coverage afforded under both forms is stated in the policies in detail and may be adjusted to meet the particular needs of the individual insured.[6]

Important contracts affording a forgery and alteration protection to bankers are known as bankers' blanket bonds. These bonds offer

[6] Securities standard policy No. 4 contains five insuring clauses. Clause A supplies coverage against loss from countersigning, validating as transfer agent, or registering as registrar forged, counterfeited, raised or otherwise altered or lost or stolen securities, or those having transfers, assignments, or endorsements forged or altered. It provides coverage against loss to the insured for having issued as agent of any corporation certificates of capital stock or other obligations of the corporation against forged interim receipts, warrants, rights, or other like documents that have been forged, counterfeited, altered, lost, or stolen. Under clause B, loss is covered when payments are made for the redemption, retirement, or cancellation of securities which have been forged, counterfeited, altered, lost, or stolen. Clause C protects the insured against loss caused by having registered upon the insured's books the transfers of any shares of the insured's capital stock or any obligations of the insured which are transferable on the books of the insured against the designated perils of forgery and alterations. Clause D covers loss of the insured sustained through having acted as agent for a committee of bondholders or stockholders, or as agent for a depository for bondholders or similar committee, and while so acting having issued any certificates of deposit or other instruments acknowledging the deposit with a receipt by the insured of securities that prove to be forged, counterfeited, altered, lost, or stolen. Under this clause coverage is also provided in the case of securities that are delivered in exchange for forged or altered certificates of deposit. Clause E provides indemnity for loss through the countersignature, validation, or registration by any transfer agent, or registrar of the insured, of any certificates of the insured's capital stock or instruments or obligations of the insured, or purporting to be the insured's own issues, that have been forged counterfeited, raised, or otherwise altered, lost or stolen.

in addition to forgery, a wide range of coverages, including the various classes of theft losses. Since, however, an important part of the cover has to do with dishonest acts of employees, the bankers' blanket bond is, in large part, a fidelity coverage. The coverage under this bond will be noted at length in the discussion of bonds;[7] it is merely mentioned here because many large banking institutions obtain their forgery coverage under it.

Comprehensive Dishonesty, Destruction, and Disappearance Policy. This contract, familiarly known as "the 3D policy" is designed to provide the broadest possible coverage for business firms. It is available to any insured except organizations eligible for bankers' or brokers' blanket bonds and federal or public officials, their deputies, and employees. The bond provides in a single document five forms of protection which, taken together, provide a broad range of financial security. The policy provides: (1) dishonesty insurance; (2) all-risks coverage within the premises; (3) all-risks coverage outside the premises; (4) all-risks coverage on securities in safe deposit boxes, and (5) forgery insurance on outgoing checks.

In addition to the coverages ordinarily obtainable under the forgery, robbery, and burglary policies, this contract provides indemnity for losses of money and securities sustained as the result of "disappearance, destruction, or wrongful abstraction of such property." Because of the breadth of this coverage, protection is extended to every conceivable type of dishonesty loss.

FOR REVIEW

1. Does the bank burglary and robbery insurance policy provide insurance against loss of the contents of rented safe deposit boxes?
2. The residence burglary and theft insurance policy covers the hazards of burglary, robbery, theft, and larceny. A delivery boy enters the premises with the consent of the owner. With a sneak thief, the situation of course is not the same. Does the residence burglary and theft policy make any difference in the coverage of a theft by one or the other?
3. Indicate some of the hazards covered by a residence policy insuring against loss from larceny.
4. A burglar attempts to enter a bank through a coal chute. He finds himself trapped in the coal bin and, unable to extricate himself, inevitably sets off the burglar alarm. The police arrive and arrest him. It is later found that the burglar alarm has been short-circuited and ruined and will cost $800 to repair. The bank carries a bank burglary policy. Is the loss covered?

[7] See Chapter XL.

5. Does the residence burglary and theft policy cover the loss of a watch taken by force from the named insured while walking from his place of business to his residence?
6. A residence burglary policy is written in the name of John Blank. Are the following losses covered?
   a) The theft of a ring belonging to the insured's mother who resides permanently with him.
   b) Theft of a chauffeur's overcoat.
   c) Theft of a daughter's ring.
7. In an effort to open a safe in a dwelling, an explosion severely damages a fine oil painting. The burglar fails in his attempt to open the safe and takes nothing. Is the property damage loss covered under the residence policy?
8. The M department store carries a depositors' and/or commercial forgery policy which, under the so-called "section B," indemnifies the insured against loss through the receipt in good faith of checks or drafts with the name of the maker or drawer forged. The store cashes a check for $100 upon which payment is refused by the bank on the ground of forgery. A second check for the same amount is taken in another department for which goods in the amount of $80 are delivered together with $20 cash. To what extent is the store covered?
9. The A B C Company operates a department store and carries a stock of $20,000 consisting of men's clothing. B is a customer of the store and purchases a suit and overcoat and leaves it for alterations. As a result of a burglary, the coat of B is stolen together with the garments of a number of other customers. The A B C store carries a mercantile open stock burglary insurance policy. In making up its claim it wishes to collect not only for its own items lost but also for the items that were sold and left with its repair department for alterations. What is your opinion of the A B C Company's position?
10. An explosive is placed under the vault in a bank carrying a bank burglary policy. A strike has been in progress in the vicinity, and certain of the officers of the bank were notoriously in sympathy with the employees. There is a suspicion that the bomb was maliciously placed in the bank building by disgruntled strikers. To what extent must the bank prove that it was placed there in an attempt to open the safe before it can collect for the damage under the bank burglary policy?
11. A bank having 1,000 safe deposit boxes which it leases to its customers secures a blanket safe deposit box policy in the amount of $100,000. As the result of a burglary, A claims to have lost $15,000 worth of jewelry and securities. B claims to have lost $3,000 in jewelry and $1,000 in money. C claims a loss of $8,000 in jewelry, silverware, and securities. How much may each collect?
12. X, a customer of the Blank Savings Bank, reports to the treasurer that a bond is missing from his box. Since the bank carries a blanket safe deposit box policy and the coverage extends to securities, a claim is filed immediately with the insurance company. The company denies liability. Upon what grounds is it justified?

13. The Blank Fur Company has on display in one of its show windows a sable coat valued at $30,000. As a result of a planned burglary, the window is broken and this and several other coats are taken. The burglars make their escape in an automobile. The company carries an open stock burglary policy and proceeds to file its claim. What facts bearing upon this loss should have been made known to the policyholder when the policy was issued?
14. Mrs. B has for a number of years carried a silverware floater policy to protect her flat silver against loss. She is now told that because of a ruling of the National Convention of Insurance Commissions this policy may not now be written to cover silver in the permanent residence of the insured. She wishes other protection than fire and is concerned primarily with the danger of losses occasioned by theft. How can this coverage be effected?
15. To the depositor who states he does not need forgery protection because the bank is responsible for his forgery losses, what would be your reply if you were his insurance adviser?
16. The X Department Store carries a depositors' forgery policy. The A bank pays a forged check and the insured files a claim under its policy. The insurance company pays the loss and the question is now raised to to whether the insurance company through the operation of subrogation has any rights against the bank. What is your opinion?
17. The forgery bond or policy defines the instruments, such as checks, notes, or the like, as well as the signatures, such as drawer, maker, or endorser, to be covered under the contract. The policy does not, however, define forgery. How is the insured to be guided in any question of doubt as to whether a loss comes within the scope of the policy as respects the forgery coverage?
18. The bank in an important midwestern city had the regular door to its vault removed and a temporary fireproof door installed in its place. While the alterations were taking place the bank sent all of its securities to a neighboring safe deposit vault. The temporary door of the vault was forcibly opened during the night and the contents of certain of the safe deposit boxes stolen. The insurance company covering the contents of the boxes denies liability. Can it be forced to pay?
19. In an attempt at burglary of the Blank Bank a quantity of paper money was destroyed beyond salvage. Does the bank burglary policy cover such a loss?
20. X is the town treasurer and has in his possession a number of blank bonds. He fraudulently issues a number of the bonds and hypothecates them as collateral security with a stock broker. The collateral is ultimately sold and the bonds are passed to the hands of a holder in due course. When these bonds are presented for redemption, the town refuses to pay them on the ground that they have been fraudulently issued and are in fact forgeries. Assume that the town is correct in its contention and it is not obligated to make payment on these bonds, is there any form of insurance that the broker could have carried that would indemnify him for his loss?
21. To what extent are forgery losses a matter of risk to (*a*) the individual or business institution writing the check, and (*b*) the bank called upon to make payment.

Chapter XXXI

MISCELLANEOUS CASUALTY COVERAGES

PLATE Glass Insurance. The uses of glass for light, display, and ornamentation have reached such an extent that the investment in the glass used in a structure or in connection with the operation of a business represents the outlay of large sums. The growing use of large plates tends to concentrate substantial values; and glass, because of its nature, is peculiarly subject to breakage. Since other forms of insurance protect glass only if injured by the particular peril insured against under the specific contract, and even then only to a limited degree unless specifically insured under a broad contract such as is offered under the plate glass policy, the owner of the glass is liable to loss from a great many sources.

Earlier plate glass policies were written with a number of exclusions. An insured today under the broadened contract now offered obtains a policy that is in effect an all-risks coverage. The only exclusion in the policy applying to damage to the insured glass applies to loss caused by fire. Such loss is covered by the fire policy on the building. The policy covers damage to window frames, sashes, or bars up to $75, provided the repairing or replacing of such sashes is made necessary by damage to, or accidental breakage of, the insured glass. Glass bricks, rotogravure screens, lenses, and neon signs are insurable under the glass policy.

The insurange clause of the policy undertakes to indemnify the insured against loss of or damage to the glass, lettering, or ornamentation described in the policy schedule as insured, when the loss or damage is caused by accidental breakage of the insured glass. Therefore, glass broken by windstorm, expansion cracks, flying substances, settling of a building, earthquake, or other accident is covered by the policy. Until recently, the policy provided protection only in the event of actual breakage. It has now been extended to cover damage caused by acid or chemicals. This coverage was formerly available but for an additional charge.

While the insuring clause specifically mentions as included within the coverage lettering or ornamentation on the glass, it is to be noted

that in order to be covered such lettering must be described in the schedule and a specific amount of insurance applied thereto. Unless otherwise described in the schedule, each plate insured is covered as plain plate flat glass set in frames, and replacement or other adjustment is made accordingly.

The policy requires that in the event of loss, immediate written notice be given the company either at its home office or to its authorized agent. The policyholder is further required to make all reasonable efforts to preserve the glass and prevent further loss or damage.

Immediate notice affords the company an opportunity for investigation as soon after the accident as possible. Such an investigation is carried on with a view to fixing responsibility for the loss and collecting damages if possible. The requirement obligating the insured to prevent further loss after a break is designed to preserve as much of the glass in the form of salvage as is possible. Sometimes a short crack may be stopped by a glazier, leaving a big salvage in the pane. If left without attention, the crack might run across the pane and cause considerably greater damage.

Under the terms of the policy, the company is required to replace any broken glass and any lettering or ornamentation thereon that is insured or, at its election, to make a settlement in money. In almost every case plate glass losses are settled by replacement. Money settlements as a rule are made only when the glass broken is insured for a specific amount and for some reason is not readily replaceable. In any case, whether adjustment is made through a payment of money or by replacement, the broken glass becomes the property of the company.

The company's liability under the policy is limited to the actual cost of the glass, including its replacement, at the time of the breakage. If lettering or ornamentation is insured, the company is liable for the cost of replacement at the time of the breakage. In no case, however, does the liability of the company exceed the amount of insurance stated in the schedule. Whenever it is necessary to remove or replace any frames, fixtures, or other obstruction in order that the broken glass may be replaced, the cost, not exceeding $75, is covered under the contract.

The replacement of the glass, the lettering or ornamentation covered by the insurance, or the payment in money for any loss, does not have the effect of reducing the coverage. Upon replacement, the

glass is covered automatically to the end of the policy period without the payment of any additional premium.

The policy does not make the filing of a formal proof of loss within a stipulated period of time a condition precedent to recovery, but the company may require the insured to file such a proof under oath on forms provided for the purpose.

Securities Insurance. This policy provides a broad protection against loss of securities except by infidelity. It has a particular appeal to institutions and individuals who own large values in securities. Individuals in the capacity of a trustee or treasurer of an endowed institution and investment trusts, holding companies, and brokers frequently have in their possession securities having a face value running into large sums of money. Even with the protection afforded by the safe deposit box the possibility of loss growing out of mysterious disappearances, entry to the box by misrepresentation or fraud, as well as burglary or robbery constitute a real hazard. In addition, fire, theft, tornado, riot, explosion, or other like hazards might be the agency for the destruction of the box and its contents.

The securities insurance policy covers, not only while the securities are in the leased safe deposit box or vault, but also while they are temporarily outside the box but within the depository's premises. The policy requires that the insured at all times maintain verifiable records of the securities covered by the policy and make periodic examinations; such examinations must be made at least once a year.

A similar policy is available to cover securities handled by outside messengers, and a third form of securities insurance covers all loss or destruction to securities while on the insured's premises.

Money and Securities Destruction. This policy provides a form of insurance excluded by almost every other type of policy. Protection is provided for money and securities against the hazards of fire, windstorm, earthquake, and such other hazards as the insured may deem necessary to include and the company is willing to assume. Only the physical damage to or destruction of money or securities is covered. There is no coverage for loss occasioned by theft, larceny, or disappearance, nor does the policy cover records, accounts, or manuscripts. Money and securities inside or outside a safe or vault are covered while the premises are open for business. When the premises are not open for business the coverage is limited to cover money and securities locked in a safe or vault.

With the exception of certain bonds written for financial institutions, policies covering on property insurance specifically exclude losses growing out of destruction of money and securities.

Valuable Papers Policy. One of the most recent of the casualty policies covers all loss or destruction of, or damage to valuable papers including, but not limited to, books, records, maps, drawings, abstracts, deeds, etc., and similar written, printed, or otherwise inscribed papers and documents used by insureds in their business.

Power Plant Insurance. Policies issued upon boilers, turbines, flyweels, electrical machinery, and other objects covered by power plant insurance provide two classes of coverage, direct loss and indirect loss. A single policy may cover boilers, machinery, or both.

Direct loss provides indemnity in the following cases: (*a*) damage to insured's property whether to the insured object or to other property; (*b*) damage to the property of others for which the insured may be liable; (*c*) liability for loss of life and injury to employees when the coverage is not prevented by the compensation laws of the jurisdiction; (*d*) liability for loss of life and injury to persons who are members of the public, that is, not employees.

Indirect loss is covered as follows: (*a*) business interruption under a use and occupancy form; (*b*) indemnity for indirect losses caused by an accident when there is no business interruption under the outage form; (*c*) consequential loss to perishable materials when caused by accident to the boiler or other object insured.

Boiler Insurance. Steam boiler insurance provides indemnity for loss or damage caused directly by the explosion, collapse, or rupture of the insured boilers. An identifying schedule listing the boilers covered, the pressure approved by the company for each, the kind of boiler, the identifying numbers, and other essential data is made a part of the policy.[1]

[1] The boiler polcy is not confined in its use to the insuring of steam boliers but may be used to provide insurance for numerous other vessels in industrial plants which are liable to explosions from internal pressure. Among the vessels upon which insurance is commonly written, and for which rates are provided, are air tanks, hot water tanks, kettles, kiers, mangle rolls, matrix tables, purifiers, radiators, receivers, refrigerating systems, rolls on paper machines, rotary bleachers, separators, steam drums, steam pipelines, separately fired superheaters, and water heaters.

In connection with boiler insurance it is customary to apply the term "object" when reference is made to the vessel covered. The word "object" is then to be interpreted in accordance with the manual definitions for the specific types. Thus, a boiler is an object, but reference to the manual indicates that with respect to a boiler the term "object" includes the boiler as described and its water columns, steam and water gauges, safety

The boiler coverage excludes liability for loss or damage resulting from an explosion caused by the burning of the structure containing the boiler, or for loss or damage by fire resulting from any cause whatever. Such losses are covered by the fire policy insuring the property. Second, the policy excludes liability for loss or damage from the explosion of a boiler while any safety valve limiting the pressure in it is, with the insured's knowledge and consent, removed, rendered inoperative, or set to blow off at a pressure in excess of that approved for it by the company as stated in the policy schedule. Liability for bodily injury to employees of the insured, who are subject to the provisions of the compensation law of the jurisdiction, is not covered. Some states will not permit this coverage to be written in connection with boiler insurance. In states where there is no statutory limitation the compensation or employer's liability coverage may be included in the policy by endorsement for an additional premium. Finally, the policy excludes loss from stoppage of the plant or from any other indirect result of an explosion. Indirect loss may be covered under special forms.

Policies covering cast-iron boilers may be written to cover the hazard of the cracking of sections. The hazard is always recognized in connection with cast-iron boilers by the promulgation of a specific charge for its coverage in the policy.[2] Insurance against cracking is obtainable only in connection with the explosion coverage.

Under the terms of the policy, provision is made for a stipulated amount of insurance to apply in any one accident. This amount is termed the "limit per accident." This limit applies to every accident

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valves, water walls, water screens and water grates, any superheater wholly or partly within the setting of the boiler, any steam economizer not possible of operation with any other boiler, interconnecting pipes and fittings, feed pipe, steam pipe, return pipe, and blowoff pipe to and including the nearest valve in each such pipe. The term also includes that part of any apparatus under pressure of steam or water which is within the furnace of the boiler, even though not directly in the boiler circulation. From the foregoing it is at once apparent that in connection with vessels insured under a boiler policy, the term "object" is more inclusive than the term by which the vessel is ordinarily designated. Reference to the manual definitions will indicate for the various types of vessels insured how much is included under the term "object" as applying to particular vessels.

[2] The boiler policy defines an explosion or rupture as a sudden substantial tearing asunder of the boiler, caused solely by steam pressure, or by the internal pressure of air, gas, or liquid if the boiler is described in the schedule as containing it. Collapse is defined as a sudden crushing or forcing inward of the furnace or the flues of the boiler, resulting in a rupture thereof caused solely by pressure of its contents.

during the policy term and applies to one accident whether or not more than one insured object is involved. If two or more objects are involved in a single accident, the highest limit applying to any one of the objects applies.

In the case of insurance applying to personal injury liability, a limit is provided, termed 'limit per person." This limit is the amount available for each person injured and must in all cases be a part of and never exceed, the limit per accident specified in the policy. The insurance for personal injury liability written under a boiler form is considered as excess and noncontributing insurance when there is other like insurance. It is effective and applicable only to that portion of the insured's loss that is in excess of valid and collectible indemnity required to be paid under a contract of other similar insurance.

The standard limit per person is $5,000. This may be decreased or increased with a corresponding premium adjustment. The limit per accident may be several times the amount of the limit per person.

Expediting Charges. Upon the payment of an additional premium direct damage policies may be endorsed to cover, in addition to the amount of the direct damage, expediting costs incurred in effecting the speediest possible replacement of the damaged property. These charges include expenses incurred in effecting temporary repairs or extra expense for overtime work or for rushing transportation of material by an agency more expensive than would ordinarily be used. The amount payable under the policy is limited to the amount for which the company would otherwise be liable as direct damage loss on the property, but with a limit for expediting charges, usually of $1,000.

Consequential Loss. Power plant policies may be written to cover consequential losses as well as direct damage. In certain types of risk the consequential loss may far exceed the direct damage caused by an accident.[8] Losses of this character, which are consequences of an accident to the object insured but not directly caused by it, are not

[8] A small motor furnishing power to a pasteurizer in a dairy might burn out with but a small loss to the motor. However, even a few minutes' shutdown at a certain point in the process of pasteurizing a batch of cream might result in a loss of many hundreds of dollars. A boiler out of commission in a greenhouse, or the refrigerating system in a cold storage plant, may run a consequential loss to thousands of dollars while the direct damage loss is negligible.

covered under the property damage policy contract unless an additional premium is paid and the consequential loss endorsement attached to the policy.

Power Plant Use and Occupancy. Use and occupancy insurance is written as a separate policy covering any of the objects insured under power plant forms or may be added to the direct damage policies by endorsement. In principle the coverage is the same as the other use and occupancy forms already noted, having as its purpose the payment of continuing fixed charges and indemnification for loss of profits due to shutdown as a result of accident.

Outage Insurance. The principle of use and occupancy insurance is the provision of indemnity for loss caused by the interruption of business. There are cases in which an accident to a boiler, power machine, or other object insured would not actually cause an interruption of business, but the accident would nevertheless cause increased operating expenses during the period the insured object is out of commission.

Outage insurance provides for the payment of an hourly indemnity for each working hour that the insured object has been incapacitated because of an accident of the kind insured against for direct damage. The insurance is written by attaching an outage endorsement to the direct damage policy and specifies the amount to be paid for each hour of total outage, as well as the company's limit per accident for each object so covered. The coverage is particularly adapted to schools, apartment buildings, office buildings, drawbridges, public utility plants, conveyors, looms, cranes, dredges, shovels, and the like. An accident to the insured object may bring about no cessation or interruption of business, yet may be the occasion of substantial increased costs to handling the business while the insured object is inoperative.

Part-Time Operation. When a policy is written covering objects that are in operation only a part of the year, by endorsing the policy suspending coverage during the period of shutdown a saving in premium is effected. The rules for the part-time operation endorsement provide a credit for every period of three consecutive months that the insurance is suspended. The endorsement is not used for objects in reserve or for objects indefinitely out of service, but is designed to allow a credit for an object seasonally operated, when the period of suspension can be designated in advance.

Indefinite Suspension. There are occasions when boilers or other objects are shut down for periods of considerable length that cannot be predetermined. For such situations an endorsement is issued indefinitely suspending the insurance, and when operations are resumed, another endorsement is issued reinstating the coverage. A return premium is allowed for each thirty-day period of continuous suspension. During indefinite suspension the policy may be endorsed granting permission to operate the insured objects at intervals for the purposes of maintenance.

The Engine Policy. This coverage may be written to insure engines which derive their power from steam, oil, or gas. Pumps, compressors, and refrigerating machines are objects insurable under the form. The policy covers damage caused by sudden and accidental breaking, deforming, burning out, or rupturing of the insured machine or any of its parts. The damage must manifest itself at the time of the accident by immediately preventing continued operation of the object insured or by immediately impairing its functions.[4]

The insuring clause is drawn broad enough to include every form of breakdown. When the engine is insured, all wheels mounted on it are covered. The same types of protection are afforded under the engine policy as are afforded under the boiler policy.

Flywheels may be separately insured. Flywheel insurance may be written on many other types of revolving machinery, such as pulleys, shaft wheels, gear wheels, fans, blowers, centrifugal dryers, separators, and other rotating objects.

[4] The principal hazard in the operation of a steam engine is the flywheel. A heavy flywheel rotating at a high speed creates a centrifugal force with a heavy outward strain on the metal of the wheel. The speed of the flywheel on an engine is regulated by a governor. The governor is a mechanical device and sometimes fails to operate. Again, there may be a hidden defect in the wheel, causing a rupture at a speed calculated to be safe. Wheels improperly put together often become unsafe after being operated for a time. Whatever the cause, it frequently happens that a wheel breaks while in operation. Sometimes a rapidly moving wheel disintegrates with such force that the break is referred to as a "flywheel explosion."

The damage caused by such a break is often terrific. The force generated by a wheel racing at a runaway speed is tremendous. The momentum of a mass of metal weighing 10 to 30 tons and rotating about a mile a minute over a path 20 to 30 feet in length can be imagined. The breaking of such a wheel can entirely wreck plant, machinery, or neighboring property and cause injury and loss of life.

Engine losses, however, are not limited to flywheels. Cylinders explode, hurling fragments with terrific force. Moving parts become crystallized from "fatigue" and give way. Improper lubrication, loosened parts not promptly discovered, or other causes may result in some part of the engine giving way. Because of the force involved, a comparatively slight break of a part may start a chain of events that will end in complete destruction of the plant.

Electrical Machinery Insurance. The investment in electrical machinery is very large. Insurance, following the coverage afforded by the engine breakdown policy, is provided under the electrical machinery form to provide protection against losses from breakdown. The term "breakdown" is defined as "the sudden, substantial and accidental breaking or burning of the machine, or any part thereof, while in use or installed and connected ready for use, which immediately stops the functions of the machine, and which necessitates repair or replacement before its functions can be restored."

Power Interruption Insurance. An accident in a power plant causing loss to a user of the power through the interruption of the service is not covered by the electrical machinery policy. Insurance providing indemnity against loss arising from the total or partial deprivation of usable service furnished by a public utility, when such deprivation is caused by an accidental occurrence to the physical equipment of a public service system, is provided by the power interruption form. The policy may be written to cover the service of electricity, steam, water, gas, or refrigeration. Two forms of coverage are available: hourly indemnity for loss of use, and property loss due to spoilage.

Turbine Insurance. The protection afforded under the turbine policy is essential the same as that provided in the other power plant policies. Direct and consequential loss to property may be covered, as well as liability for personal injury. Four kinds of coverage are written, each furnishing a different degree of protection. These are: (1) breakdown insurance; (2) explosion insurance; (3) limited breakdown; and (4) combined coverage.[5]

1. *Breakdown Insurance.*—This is the most complete form of

[5] A turbine is a rotary engine which converts the energy of supplied water or steam into mechanical or electrical energy. A delicately balanced rotor enclosed in a heavy outer casing turns upon the impact of the steam or water. Turbine rotors frequently weigh several tons, and rotate at speeds from 1,200 to 20,000 revolutions per minute. The centrifugal force so generated is capable of terrific destruction both to the machine itself and to surrounding property and life. Large units, such as are used for generating power by public utility companies, not infrequently cost a million or more dollars. Parts are so heavy that to move them to effect repairs frequently involves the expenditure of many thousands of dollars.

There are two classes of turbines—steam turbines and water turbines. For the purposes of rating, each class is further divided into two groups—those with driven electric generators and those with other driven objects. Besides driving generators, turbines operate fans, pumps, and other kinds of machinery. Where steam is used, the pressure is often very high, ranging from 100 to 3,000 pounds per square inch, and the explosion hazard forms an important part of the risk.

insurance obtainable on a turbine since it covers all the major hazards, including all types of explosions, the burning out, short-circuiting, or breakdown of electrical equipment, as well as accidents to the rotor, such as the stripping of the blades or other breakdown.

2. *Explosion Insurance.*—This form is designed to protect the insured from catastrophe losses. Accidents involving the breaking or rupturing of the shaft or rotor and explosions due to steam pressure are covered. An explosion is defined as the "sudden and substantial tearing asunder as a result of the pressure of steam of those parts of the turbine subjected to steam pressure; or the sudden and substantial bursting or disruption of the rotor, while revolving, into two or more parts." Losses caused by breaking, cracking, stripping, or loosening of gears or couplings or of movable or stationary blades are not covered. Likewise, the policy does not cover losses caused by short-circuiting, burning, breaking, or loosening of electrical conductors.

3. *Limited Breakdown.*—Under this form the broad breakdown coverage is provided, with the exception that electrical burn-outs on the generator rotor are excluded from coverage.

4. *Combined Coverage.*—This form provides a combination of turbine explosion and generator breakdown. The steam end of the equipment is provided with explosion coverage only, while full breakdown insurance is provided for the generator and exciter.

Patent Protection Insurance. This contract is designed to protect patentees against infringement of their patents and to defend suits against patentees for alleged infringement of the patents of others. There are two forms of contracts issued, known as (1) protective contracts and (2) defensive contracts.

The protective contract covers legal expenses of suits brought by the policyholder for infringement of a patent or trademark. The insured has a claim under the policy whenever he discovers an infringement of his patent. Upon notice to the insurance company a settlement is attempted; and if this proves impossible, the policyholder is authorized to institute suit against the infringer. The costs of the suit up to the face of the policy are paid by the insurance company.

Defensive contacts cover legal expenses of defense of suits brought against the insured for alleged infringements of patents or trademarks of others and also pay damages if any are awarded against the policyholder. Such a policy may be extended to cover, not only the policyholder, but his customers and any others who may be liable to suit by

reason of use of the patent or trademark owned by the policyholder. A certificate of protection is issued by the insurance company to each customer named in the policy. Policies also may be written covering damages only, by excluding legal expenses.

Defense contracts for product and process protection may be written. The product or process policy is issued to manufacturers and merchants and defends them against loss growing out of the charges of infringement of patents because of the manufacturer, sale, or use of the protected product or process.

Patent protection and product and process protection are highly specialized forms of insurance and are not ordinarily offered except through specialists carrying on a business in the field. The business is comparatively new, and there has been a tendency in recent years to discontinue writing protective contracts. Some organizations have discontinued them altogether.

Contractual Liability. Since the public liability insurance policy covers against loss occasioned by "liability imposed by law," it follows that any liability specifically assumed by the insured is not covered. It would seem that an insured would recognize any instance of the assumption of such contractual liability. Frequently he does not, or, if he does, he does not recognize the effect upon his liability policy.

A common case of contractual liability is to be found in the clause almost universally inserted in agreements between railroads and property owners when siding or spur track is built for the convenience and use of the property owner. In the contract as usually drawn, the property owner assumes responsibility for injuries to persons or loss to property due to the use, existence, or maintenance of the siding. Again, most cities require a contractor to assume all the liability of the municipality before granting a permit to use the city streets to store material, bridge the sidewalk, or otherwise make use of the highway in connection with his operations.

While the liabilty policies are written afford no protection for assumed liability, with the consent of the company the coverage may be incorporated in the contract by endorsement.

Owners', Landlords', and Tenants' Public Liability. Legal liability for loss or damage for which the insured is responsible through the ownership or control of real property is covered under the owners', landlords', and tenants' form.

The policy usually carried affords indemnity for legal liability and

expense under claims which arise from bodily injury or death suffered by members of the public. It is to be noted that property damage claims are not included, but the coverage may be provided by endorsement and payment of an additional premium. Likewise, the protection extends only to the public, thereby excluding employees.

The policy covers the insured's liability for all types of accidents occurring on the premises, excepting only cases of assumed liability by the insured under contract, or occasioned by extraordinary alterations and repairs. It extends to accidents off the premises if caused by employees of the insured engaged in the same type of operation as conducted at the premises. Automatic coverage on newly acquired locations or undertakings is provided if the company is notified within fifteen days after acquisition of the new risk. This feature does not apply if the insured is covered by other valid and collectible insurance.

The hazard under this form of coverage is twofold. Types of businesses in which the principal exposure is within the place of business fall into one category, while in a second type of business the outside hazard constitutes a substantial part of the exposure. The "on the premises" hazard not only includes claims from tripping, falling on stairs or slippery floors, and the like but extends to sidewalks and passages adjacent. But in addition to this, claims such as that for blood poisoning as a result of scratching a wrist while fitting a glove, for the collapse of a chair in which a customer was seated, for injury to an eye caused by demonstration of a perfume atomizer, and like claims are all covered. The outside hazard assumes more than incidental importance where appliances are sold and demonstrated on the premises of the prospect. Electric refrigerators, radios, cleaners, and other household devices are demonstrated and installed in the customer's home. Accidents during demonstration or installation may involve the employer of the salesman in a heavy claim for damages.

Elevators. The greatest source of elevator claims is found in elevators of the passenger-carrying type, such as those used by hotels, apartment buildings, office buildings, stores, and othe properties were elevators are installed to carry members of the public. It is also true that in factories, warehouses, garages, and other properties where elevators are installed only for freight, accidents often occur which involve members of the public.

The insuring of an elevator against personal injury or property damage claims may be made a part of the owners', landlords' and tenants' coverage. The elevator liability, however, is not so covered unless the elevators are described in the application for the policy and specifically written into the contract. If no owners', landlords' and tenants' policy is carried, the elevators may be separately insured under an elevator liability policy.

The elevator liability contract undertakes to indemnify the insured against the legal liability resulting from accidents to the public on account of ownership, care, maintenance, or operation of the insured elevator. The coverage extends to claims originating in accidents caused while entering or leaving the elevator or caused by elevator wells or equipment.

As in other public liability policies, the elevator policy does not cover liability voluntarily assumed by the insured. Other exclusions relieve the company from liability when the elevator is in charge of any person illegally employed because of age. or in any case under sixteen years of age, or when the elevator is used while being repaired or before it is completely installed and ready for use.

In addition to assuming the risk for claims caused by bodily injury or death and for loss caused by damage to property, the elevator policy may be extended to cover the elevator itself under a collision form. This is not a liability coverage, but is written only in connection with property damage insurance, and covers loss or damage to the insured elevator resulting from collision of the elevator or objects carried in the elevator with other objects. The coverage extends to indemnify the insured for loss or damage to other property owned, leased, occupied, or used by the insured if the loss is occasioned as the result of a collision of the insured elevator. The standard limit for elevator collision is $1,000.

The premium for elevator coverages is based upon a specific charge for each elevator, depending upon the territory in which the insured elevator is located, its classification, and its use.

Theater Liability. The theater public liability policy is designed to provide liability and property damage insurance to owners or operators of theaters, motion picture houses, opera houses, auditoriums, and other properties used for any type of entertainment where large crowds are in attendance. While the same types of claims that are common to mercantile business enterprises are found to pre-

dominate in theater accidents, such as falling, slipping, tripping, tearing clothing, and the like, what ever theater owner actually dreads most of all is an accident that reaches the proportions of a catastrophe.

Because of the large number of people gathered together in an audience in a crowded theater or public hall, panic, fire, collapse of a building, or other serious accident might be the occasion of claims running to many thousands of dollars. For this reason adequate protection may be obtained only through carrying a policy with high limits.

The premium for theater liability, if the theater is operated by the insured, is based upon the total number of admissions to events conducted on the insured premises. In the case of premises used for theatricals, not operated by the insured, the premium for owner's or lessee's risk is based upon area of floor space.

Public Liability for Restaurants. The premises hazards for a restaurant differ little from those of any other business except in one respect. The danger of accidents from doors, sidewalks, stairs, floor openings, and the like is here present, and the legal liability of the insured for bodily injury or death is covered under the owners', landlords' and tenants' policy. The additional hazard peculiar to this class of business is found in the liability of the restuarant owner for damages caused by eating food.

Soapy water accidentally served in a cup of cocoa, bits of broken glass and other hard substances served in food, or bad meat or fish, causing illness and sometimes death to the patron of a restaurant indicate the type of casualty that in the past has resulted in claims. There is a record of one occasion when an employee, to revenge himself upon his employer for a reprimand received because he had broken dishes, deliberately put poison in the pies to be served that day. As a result of the disastrous consequences of this act, this coverage is not uncommonly referred to as "poison pie insurance."

The coverage affording protection in the event of claims for injury caused by the consumption or use of food on or off the premises is available in connection with the restaurant public liability policy. The coverage is endorsed on the owners', landlords' and tenants' form and an additional premium charged.

Residence Liability Insurance. The liability hazard of the private dwelling is covered under a special form. It is written at a low rate to cover either an owner or a lessee. A flat rate covers the

grounds exposure. If desired, the policy may be extended to provide property damage coverage.

A special feature of the residence form permits the extension of the policy by endorsement to include protection from loss when the claim is made by a servant or other employee injured in the course of employment. Public liability policies as a rule exclude the coverage of employees, since workmen's compensation or employers' liability forms are available, and this risk is expected to be covered by specific insurance. Since in most states the workmen's compensation laws do not apply to farm laborers or domestic servants, the insured may neglect his exposure to loss from this source. If he does not of his own volition elect to come under the compensation law, he may insure his liability to employees by extending his residence public liability policy.

One of the special hazards covered in the residence policy is the liability for bodily injury sustained by a member of the public by reason of the insured's ownership of dogs. The policy covers only the premises hazard but, by endorsement and payment of an additional premium for each dog, the off-premises hazard may be covered.

The policy is a specialized form of the owners', landlords' and tenants' coverage and subject to the same general rules.

Combination Residence Policy. A combination residence policy is offered by casualty companies and may include one of a number of hazards, depending upon the requirements of the insured. The policy is extremely flexible and permits variation in the amounts and limits of insurance, as well as variations in the particular hazards to be included in the policy. The following coverages are available: burglary; robbery; theft and larceny; glass breakage; residence public liability; water damage; explosion of and repairs and replacements to plumbing, heating, and refrigerating systems; loss of use, water damage, and explosion of plumbing, heating, and refrigerating systems; employers' liability; workmen's compensation; sports liability; golfer's liability; dog liability; saddle animal liability; personal liability; liability for minor children; liability for adult members of insured's household; property damage liability; personal holdup; damage by aircraft and motor vehicle; and loss of use.

There are many hazards in connection with the maintenance of a residence not covered in the ordinary fire insurance contract or fire insurance contract with supplemental endorsement. The fire insur-

ance policy covers damage by water used in putting out an unfriendly fire, but it does not cover damage growing out of leaks, breaks in the plumbing or heating systems, and water coming through open or broken windows or from the overflow of plumbing fixtures. These risks are all included under the water damage coverage. The explosion feature covers explosion of furnace, hot water heater, gas stoves, refrigerating systems, and the like. Water damage or explosion damage coverage provides for repairing or replacing the damaged systems, as well as the damage caused to other parts of the property.

The public liability coverage protects the insured for bodily injury to members of the public, growing out of the maintenance and use of his dwelling. Claims frequently arise from workmen or others who slip on walks, steps, or rugs. Dog liability may be included in the coverage. As has already been noted, workmen's compensation does not ordinarily include domestic servants, and employers' liability protection may be made a part of this policy. Glass breakage protects the owner of the property by providing full replacement if glass in any part of the insured property is broken. This includes glass, not only while in place, but as well while in storage or being handled for installation. The golfer's liability provides protection while the insured or members of his family included within the coverage are playing or practicing golf. Personal liability protection such as will be noticed in connection with the personal liability contract may include protection for the husband and wife, and liability for acts of minor children. Damage by aircraft and motor vehicles provides indemnity in the event of damage from falling aircraft or any object falling from an airplane. It also covers damage to the premises by an automobile not owned by the insured. Frequently guests, truckmen, or others driving vehicles on residential premises do serious damage to shrubbery, grading, fences, or the buildings themselves. Tornado coverages and loss of use provide essentially the same coverages for the dwelling property as would be obtained under separate policies covering the risk. Property damage liability, holdup protection and burglary, theft, and larceny coverages are included when required.

It is the purpose of the combination policy to provide an integrated coverage for the home owner. The policy does not meet all needs and in some instances individual policies such as residence burglary, liability, and the like may better serve the needs of the

insured. This is the case when the hazard to be covered is particularly great. For all ordinary situations the combination policy furnishes an admirable coverage.

Trustees' Blanket Liability. Because trustees have been held responsible for damages growing out of injuries caused by accidents involving property in their charge, the need for an insurance policy covering blanket the liability of trustees for all property under their control and management brought about the development of the trustees' blanket policy. The policy covers the liablitiy of owners or beneficiaries of trusts and covers the trustees as an additional interest.

The legal principle which holds the trustees personally liable is based upon the inequity of depleting the trust estate because of some breach of duty of the trustee. Failure of the trustee to keep the trust property in repair, irrespective of his right of reimbursement, will not relieve him of his responsibility to third parties, nor will it permit him to charge the trust with the consequences of his failure. Only when he is entirely free from fault has the trustee recourse against the estate for reimbursement for payments made out of his own funds.

The trustees' blanket policy is useful not only to individuals acting in the capacity of trustees, but particularly so to banks and trust companies. The policy is written to cover all properties held in trust at the time the policy is effected, and a special endorsement provides the same coverage on newly acquired properties and automatically excludes properties disposed of. The protection is the same as that coverage provided by the standard owners', landlords', and tenants' policy, with the addition of a protective coverage for the insured when an entire building has been leased to another who has control of the operation of the property and would ordinarily be held liable.

Rates are based upon the manual rates for each property covered. The insured is named as:

> The X Trust Company, in its individual capacity as Trustee, Committee, Executor, Administrator, or in any other fiduciary capacity, as the case may be, as its interests may appear and/or any owner or any beneficiary of any of the properties covered by this policy as per schedule of names attached hereto or subsequently added by endorsement.

There is no charge for including the trustee as an additional interest, and the charge for each beneficial ownership is indicated so that each estate may be charged with its proper portion of the cost.

Teams' Liability Insurance. Because of the predominance of motor vehicles on the road and the number of accidents occasioned each year by their use, most people are acutely conscious of the risk attendant upon the operation of an automobile and are familiar with the more usual automobile insurance coverages. The use of teams is by no means ended, however, and the owner of horse-drawn vehicles may find himself the defendant in a suit for heavy damages, because of careless drivers, frightened horses, loading and unloading accidents, or negligence on the part of himself, his servant, or his agent.

The teams' liability cover provides indemnity in the event of loss to the insured because of his legal liability for bodily injury or death to members of the public resulting from an accident caused through the ownership, maintenance, or use of teams in connection with the insured's business or trade. Risks of loading and unloading are also covered.[6]

Manufacturers' and Contractors' Liability Insurance. This policy is issued to provide protection for the manufacturer similar in nature to that afforded under the owners', landlords', and tenants' coverage but adapted to meet the needs of the manufacturer. The legal liability of the assured is covered on account of bodily injuries or death sustained or alleged to have been sustained, by members of the public. The clause is extended to cover the legal liability for such accidents occurring on or about the premises described in the policy and includes accidents caused by the assured's employees in his business. It also covers losses caused by such employees while engaged in the insured's business away from the premises. Property damage coverage may be written when required.

Employees are not regarded as members of the public while engaged in the performance of their duties, but it is possible for an employee to be injured on the premises under such circumstances as to be classed as a member of the public. Applicants for employment, visitors to the plant, salesmen, collectors, deliverymen, employees of contractors, children and trespassers all form a part of the public. There is also the usual sidewalk exposure.

The insured is protected under this form against accidents which

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[6] Until recently, teams' liability insurance was regarded as a separate form of insurance cover, and a manual providing rules and rates was published. Effective July 21, 1940, the rates, minimum premiums, classifications, and rules were merged and coordinated with owners', landlords', and tenants' insurance.

occur in the factories or other buildings, yards, and adjacent walks, whether caused by an act of an employee or otherwise in the course of the insured's business operations. Accidents away from the premises may be covered if desired.

Liability for accidents for which another form of insurance is designed is excluded. Such accidents are those caused by automobiles, teams, or elevators. New-construction work or the demolition of buildings is excluded. Accidents caused by the employee of a contractor or subcontractor are not covered, nor is there protection for liability for accidents caused by employees under age or by contract convict labor.

When written to cover the liability of a contractor, the protection applies at specified locations, or a blanket policy may be written to cover all locations. Included in the policy is liability for loss when the accident is caused by the use of hoists, elevators, teams, or automobiles on the premises. Contractors engaged in road paving and street construction are protected in the setting-up, taking-down, and operation of the machinery and equipment used in their work, while they are at the place and while they are being taken to and from the place of work. This includes such equipment as steam shovels, concrete mixers, road rollers and graders, tractors, and other similar equipment.

Products Public Liability Insurance. Claims for damages because of bodily injuries caused by or alleged to be caused by the consumption, use, or handling of goods away from the premises of the insured are specifically excluded from the coverage of the public liability policy issued to merchants and manufacturers. To meet the needs of insureds in various lines of business, the products public liability coverage has been developed. Liability protection is provided under this form against loss caused by sickness or disability due to the consumption, the handling, or the use away from the insured's premises of any article manufactured, handled, or distributed by the insured.

The nature of the claims allowed by the courts because of injuries sustained where negligence of the manufacturer or distributor is alleged indicates the possibility of loss from all classes of manufactured goods and further indicates that the wholesaler or even the retailer may be drawn into the suit as a defendant. Claims for negligence in packing food products are common. Again, a manufac-

turer or a dealer may be faced with claims which are the result of the use of his product. A gas heater, an inflammable comb, an automobile with a defective wheel, a pressure cooker, a defective scaffolding, a defective tractor, an electric refrigerator—all have been the occasion of accidents resulting in heavy damages to the manufacturer. In the case of a comb, a manufacturer, a hairdresser, and a retailer were all made defendants. Beverage manufacturers and bottlers face the risk of claims because of alleged injurious substance or because of breakage or "explosion" of a bottle under pressure. Filling stations sometimes get some substance other than gasoline in their tanks. Sometimes it is another product such as kerosene; sometimes salt water gets into a cargo carried at sea and later separates in the tanks and is delivered for gasoline. The substitution of gasoline for kerosene when the latter is to be used in kindling fires, may have the most serious consequences. Liability in such cases is said to be due to misdelivery. Wholesalers of drugs who have items packed by others and marketed under their label are deemed to be manufacturers and may face claims for injury to persons using the product. Manufacturers and dealers in poisons, such as hardware dealers and concerns manufacturing farm and garden supplies, have been made defendants in claims for personal injury. Aside from legitimate claims, in this field faked claims are both annoying and costly.

The products liability policy covers claims for damage caused by mistakes, imperfect ingredients, or foreign substances, as well as improper handling, labeling, packing, or delivering. The policy does not cover products consumed on the premises of the insured nor any liability for injury to employees. Goods manufactured, sold, or distributed in violation of law are never covered.

The rate for this coverage varies with the type of business, and the premium is computed by applying the rate to the gross sales. In some cases, notably in the case of bottled goods, the rate is based upon the number of items delivered. In either case an estimated premium is adjusted by an audit at the end of the policy term.

Property damage coverage is available when desired upon the payment of additional premium.

Protective Liability Insurance. This policy is used by contractors carrying on a big project in which substantial parts of the operation are sublet to other contractors. Members of the public frequently recognize only the general contractor and file their suit for damages

against him, or, if they do recognize the subcontractor, they file a joint suit. The purpose of the protective liability policy is to provide defense for the general contractor in the event that he is drawn into litigation of this character. When, however, because of the surrounding circumstances, the lines of demarcation of liability is not clear and judgment is rendered against the insured, the policy indemnifies him, subject to the policy limits, to the extent of the judgment plus expenses incurred in investigation and defense.

Property owners may find themselves joined as defendants in a suit which is the outgrowth of an accident for which a contractor is primarily liable. Property owners may protect themselves against bodily injury claims arising from the operations of contractors or the negligence of contractors' employees with the protective liability policy.

In the case of the owners' policy, premium for this coverage is based upon the total cost of the work, and in the case of the contractors' form, it is based upon the total cost of the work sublet in connection with the main contract. The risk is considered greater for contractors, and the rate is higher than that charged to owners.

Malpractice Liability Insurance. This type of coverage is designed to indemnify professional practitioners for loss or expense arising or resulting from claims on account of bodily injuries resulting from any malpractice, error, or mistake committed, or alleged to have been committed, by the insured in the practice of his profession. Professional practitioners in every field find themselves defendants in heavy damage suits, and frequently the claims are made without a justifiable cause.

Malpractice liability, sometimes termed "professional liability," as in the case of other liability coverages, indemnifies the insured, subject to the policy limits, for loss because of any legal liability for bodily injury or death, and in addition provides for the payment of all costs of defense, investigation, and other expenses of settlement. Property damage insurance is not written under a malpractice coverage.

Limits of liability under the professional policy differ from the usual liability coverage. Standard limits are $5,000 and $15,000. In the case of the professional policy, the lower limit of $5,000 is the maximum liability under a single claim, and the upper limit of $15,000 represents, subject to the same limits, the maximum liability

during the policy term. Other liability policies set no limit for the policy term, but the upper limit applies to any single accident.

Insurance companies write malpractice liability under several different forms, designed to meet the particular needs of a particular group. All companies writing professional liabilty insurance do not issue policies for all the covers. The regularly written forms are: (1) physicians', surgeons', and dentists' liability; (2) business (clinics, etc.) liability; (3) hospital liability; (4) druggists' liability; (5) optometrists' liability; and (6) beauty parlor liability.[7]

Libel Liability. A policy undertaking to indemnify the insured for loss through the settlement of libel claims is issued to newspapers and other classes of publishers. The risk covered is something more than the liability due to negligence which is assumed by the usual liability form. A publisher who holds a person up to scorn, contempt, or ridicule may find himself liable for heavy damages. Damages must be paid when a damaging, untrue statement is published maliciously. The law recognizes two classes of malice. When there is a deliberate desire to injure there is malice in fact. A careless disregard for another's rights constitutes malice in law. Absence of intent to libel does not constitute a defense. Publication of a retraction is not a complete defense and serves only to mitigate damages.

Suits against newspapers amounting to hundreds of thousands and millions are not at all uncommon. A record of actual judgments indicates that publishers constantly face a very real risk of loss through libel claims. Libel insurance is written on an excess coverage basis to cover the risk. Small losses up to a designated sum are met by the publisher. The policy assumes only the burden of the very large losses.

In the adjusting and settling with claimants, this policy introduces a provision radically different from the usual liability form. The insured is required to conduct his own defense and pay all attorney's fees and other costs of litigation, the company having the right, if it wishes to exercise it, of participating in the defense at its own expense. The company is not required to appear until the amount actually to be paid to the claimant has been determined, and then it is liable to the insured for the excess stipulated in the policy.

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[7] Indicative of the trend in this field, a policy has been made available covering the professional liability of morticians, and a policy providing like coverage has been offered for attorneys and another for surveyors.

Sports Public Liability Insurance. A policy covering the golfer's liability for claims on account of bodily injury or death suffered or alleged to have been suffered by a member of the public by reason of the insured's participation in any game of golf is now written and known as "golfers' liability insurance." The contract extends to cover no person other than the named insured, and is limited territorially to the United States, Puerto Rico, Cuba, and Canada.

If the insured participates in other forms of sport, such as tennis, baseball, polo, basketball, football, hockey, and fishing, the policy may be endorsed to furnish the additional protection required.

The most important exclusions provide that the company will not be liable for claims occasioned by accidents arising out of ownership, maintenance, or use of aircraft, automobiles, bicycles, motorcycles, boats, or vessels of any description. Likewise, the company assumes no liability for loss occasioned by an accident with firearms. The coverage offers no protection for claims occasioned by accidents with animals except in a single instance. It does extend coverage to polo ponies while they are used for playing or practicing the game of polo. The policy does not cover claims for injuries caused by the insured while participating in any game or sport as a professional, but this exclusion does not apply to golf or tennis, and the policy may be extended to include professional participation in other sports.

As in the case of other liability coverages, property damage insurance may be included for an additional premium. The premium for bodily injury and property damage is at a flat rate, charged for each individual covered in the policy.

Some companies now write a broad sports liability which extends to cover the insured for liability for bodily injury, the result of an accident while practicing any athletic sport or game or participating in one. It also extends the same protection to fishing, hunting, target practice, and the use of firearms. It likewise protects the insured while using saddle animals not owned by the insured and while using for other than commercial purposes bicycles, canoes, or rowboats, as well as power boats or sailboats not owned or chartered by the insured.

Personal Liability. The personal liability policy provides in a single contract cover ordinarily to be obtained in the sports liability policy and the residence liability policy combined, and in addition includes liability for actions growing out of the personal acts of the

insured or of his minor children. The policy covers the liability of the insured in connection with personal, as distinguished from business, acts and omissions, and also affords medical payments coverage for injuries regardless of liability.

The policy under the personal feature covers the insured if by some innocent act he is the cause of injuring another. A frequently cited case is that of a young woman who sued for $20,000 for alleged injuries from a cigar burn, the outgrowth of a collision with the smoker on the street. Other cases are on record in which the acts of children, apparently committed without any malicious intent, involved the parents in serious litigation. In connection with the coverage under the personal liability contract, it is to be pointed out that the policy covers only the liability of the insured for the acts of his minor children and does not cover the liability of the children themselves. There is a difference in that the parent is not liable for all the acts of his minor children, and the child may himself be liable for his own wrongful acts. It is, therefore, quite possible that a child be legally liable but unable to meet damages in a situation in which the parent cannot be held liable. If the insured wishes the liability of children to be covered, as well as his own liability for their acts, the policy should be so endorsed.

Personal liability policies do not cover any liability arising out of the insured's business or profession or the business or profession of his children. Liability to employees is excluded, as well as liability growing out of any willful, deliberate, or malicious act of the insured. Contractual liability and any liability caused by the employment of any person in violation of the law as to age are excluded. Accidents caused by boats, except canoes or rowboats not equipped with motors, are not covered. Liability, except on the insured's premises, caused by aircraft or the ownership, maintenance, or use of any automobile or motorcycle is excluded. Likewise, liability for claims growing out of the ownership of draft animals or vehicles drawn by them is not covered. The same protection is given dogs as is available under the residence liability policy. The policy covers liability for saddle animals not owned by the insured, and it may be endorsed to include saddle animals away from the premises, the property of the insured. The premises hazard for animals owned is covered. As in the case of the residence liability contract, employers' liability or domestic servants' compensation may be endorsed in the contract. Other

members of the insured's household may be covered by agreement with the company and payment of an additional premium.

The Comprehensive Liability Policy. As one of the most recent developments in the liability field, casualty insurance companies are now writing a comprehensive policy designed to include in a single contract insurance protection against all the liability perils to which an insured may be subject. Prior to the revision of this policy it was necessary for the insured, in building up his liability protection, to select such of the single peril policies as he felt met his needs. The danger of this procedure is to be found in the possibility of gaps in the coverage of or unforeseen exposure for which no policy is provided. Finally, claims sometimes develop as the result of exposures that do not come within the scope of any of the named perils policies. With a comprehensive policy covering all public liability, the insured has the most complete liability protection that can be purchased.

Comprehensive policies are provided in several different forms. Some policies are written covering bodily injury liability, including automobile liability and automobile property damage coverage. Such policies do not cover the property damage other than that growing out of automobile claims, but this general property damage coverage may be added by endorsement. Some policies are written to cover all public liability and property damage claims, but excluding automobile coverage, while the most complete form covers all public liability and property damage claims, including automobile.

The comprehensive policy is so broad that it covers all third-party liability because of bodily injury, sickness, or disease, and injury to or destruction of property. In addition, it provides full automatic coverage for all included exposures; that is, if a claim arises because of the acquisition of some property creating a liability peril subsequent to the writing of the policy, the coverage automatically attaches. Provisions are also made for the so-called "unknown hazard" when the insured may be subject to some peril about which he knows nothing or a peril which, the ordinary course, would not be covered by any named perils policy.

Exclusions under the policy have been reduced to a minimum. While all contracts are not identical, the following exclusions are found in one form or another: (*a*) watercraft or aircraft; (*b*) employers' liability and workmen's compensation;, (*c*) property in care, custody, and control of the insured; (*d*) water damage liability, in-

cluding sprinkler leakage. Not all policies include the water damage exclusion, but when water damage liability is not to be covered the policy is endorsed accordingly. On the other hand, if the exclusion is found in the policy, water damage protection may be included by endorsement.

Premiums for the comprehensive liability form are computed by determining manual rates for all known exposures when the policy is written, and to the premium thus determined a 1 per cent charge is added to provide for the "unknown hazard." The policy is in effect, then, a combination of all the known policy forms that, in the ordinary course, would apply to the risk plus an over-all coverage designed to make the protection complete.

FOR REVIEW

1. Name the exceptions in the plate glass policy.
2. May a glass plate already cracked be insured under a plate glass policy?
3. During a strike, chemicals are thrown upon the plate glass windows of X company. Is the damage covered under a plate glass policy?
4. X is the president of a bank and is considering the application of the Y company for a large loan. X discovers that Y leases a mechanical apparatus and in the agreement undertakes to hold the lessor "harmless" from all losses caused by the operations of the leased machines. How can the borrower satisfy the bank with reference to this hazard?
5. A, in swinging his golf club during practice, strikes a bystander on the forehead with a resulting serious injury. Does the golfer's liability policy cover this situation?
6. An employer of an electric company calling at the residence of X to read an electric meter steps on a golf ball left on the back porch, falls, and breaks his leg. Is the liability of the owner of the ball covered under the golfer's policy?
7. Mrs. B, a maid working in the house of X, was engaged in cleaning clothing with gasoline supplied her for the purpose by her employer. The gasoline fumes vaporized and resulted in an explosion which caused the death of Mrs. B. Mrs. B's husband brought suit for damage against the employer. Has he grounds for a claim?
8. X has a mortgage upon a building located in the business district of a small city. Because of the failure of the mortgagor to meet payments, X forecloses and takes possession. The morning he takes possession a woman falls and breaks her leg. May she bring suit against the mortgagee in possession, and what is his liability?
9. X is the owner of a building which he has leased in its entirety to a second party. He feels, therefore, that he has no need for a public liability policy since, under the terms of the lease, the tenant has assumed all liability in the

event that anyone is injured on the premises. Is the owner thereby relieved of all risks?

10. Failure of the brine cooler in the refrigerating system at a southwestern poultry and egg plant endangers over 300 employees. One was killed, eight were injured, and the property loss was in excess of $100,000. Is this risk insurable?
11. Aside from the inspection of insured power equipment by experts, name some of the other services rendered by companies writing boiler insurance.
12. State briefly the type of machinery that may be covered by a company writing power plant insurance and indicate briefly the hazards covered.
13. A steam or hot-water heating boiler in a residence, or any hot-water tank or heater, may as a result of accidental overpressure cause a violent explosion with serious loss. How should this risk be insured?
14. It is sometimes said that the inspection feature afforded with a power plant policy is of greater value than the insurance feature. Explain.
15. What are the principal insurance coverages to be found in the so-called "malpractice group"?
16. Dr. X carries a malpractice policy that requires that immediate notice in writing be given to the company with fullest information obtainable at the time if any claim is made on account of malpractice. Mrs. Y, a patient, wrote Dr. X in March advising him of a claim. Dr. X felt there was no liability and so notified the claimant. A month later he received another letter from an attorney stating that he had been instructed to take legal action in the case, to which the insured again replied denying liability. A year later suit was brought, and the insurer upon learning of the circumstance denied liability. In your opinion is the insurance company liable?
17. X threatens a doctor that unless he pays $1,000 he will bring suit against him alleging malpractice. It is an attempt to extort money by threat of injuring the doctor's reputation in the community. Does the doctor's malpractice liability policy cover against such a claim?
18. A druggist carries an owners', landlords', and tenants' liability policy. A claim is made for illness caused by eating food served in the store and claimed to have been spoiled. Another claim is filed on the ground that illness was caused by consuming fruit juice purchased at the store and used to make punch at the home of claimant. A third claim is filed based upon an alleged error in the compounding of a prescription. Which of these claims are covered under the druggist's owners', landlords', and tenants' policy?
19. B, a customer of a restaurant, alleged that he became seriously ill as a result of eating spinach in which pieces of glass were later found. He brought suit against the restaurant and a verdict of $500 was rewarded. Is this risk insurable?
20. A manufacturing plant carries an owners', landlords', and tenants' liability policy which, among the exclusions, lists contractual liability. The manufacturer wishes contractual liability coverage and carries his policy to his agent with instructions to provide it. The agent, therefore, prepares an en-

dorsement eliminating the exclusion to contractual liability. Has he succeeded in providing the insured with the contract he requires?

21. A tenement property, upon the death of the owner, was placed in charge of three trustees. A lodger in one of the tenements tripped over an obstruction in the hallway and was seriously injured. In your opinion, if a verdict is rendered in favor of the tenant, from what funds will it be paid?
22. The apartment building belonging to S is covered by an owners', landlords', and tenants' liability policy. S dies, and shortly thereafter a claim is filed against the executor of the estate for an alleged injury. The executor refers the claim to the insurance company writing the liability policy. Is the estate covered?
23. The Standard Ice Cream Factory operates its pasteurizers with electric motors. These are insured under a power plant policy against burn-out. On a certain occasion a motors burns out with a loss of $75 for repairs and a loss of $2,000 to cream in process of pasteurization. How much may the insured collect?
24. In the foregoing case describing the cream in the pasteurizer, if there were no burn-out or other direct damage to the motor, but the cream was spoiled due to an interruption of power, the result of an accident at the power house of the public utilities company, would the insured's power plant policy provide indemnity for loss or damage to the cream?
25. X, a general contractor, in undertaking to repair a bridge, it was contended, failed to provide either a barricade or lights, and as a result an automobile accident occurred which seriously injured the driver. Suit was filed against X, and damages in an amount of $20,000 were awarded. How could the contractor have protected himself with insurance?
26. B, an employee of the X company, falls through an open shaft, left open by the custodian of the building of which X is a tenant. The A B C bank is trustee of the property, and suit is filed against the bank. The bank contends that in the capacity of trustee it is agent for the owner, and any verdict rendered must be charged against the property. Is the bank's contention sound?
27. The plate glass insurance policy covers loss due to accidental breakage. During a strike several plates of glass in an insured property were deliberately broken. What is your opinion as to coverage?
28. B, a laborer working in the vicinity of a mercantile building, sits in the shade of the building at noon to eat his lunch. An iron shutter that has been swaying in the wind breaks loose, falls, and injures the workman. The income from the building is paid the widow of the former owner, and Jones, the family lawyer, is the trustee appointed under the will to collect the rents and manage the property. The laborer files suit and is awarded a verdict of $10,000. Who pays?
29. X, the owner of a department store, finds a plate of glass to have been scratched by persons writing their initials on the glass with a diamond ring, or some similar hard substance. The scratches are unsightly, and the owner of the property asks the insurance company writing the plate glass policy to repiace the glass. Is this loss covered?

30. A fire in the adjoining premises causes two large plates of glass to crack. The insured presents a claim under his plate glass policy and is told by the company that the loss is a fire loss. May the plate glass insuring company justly disclaim liability on this ground?
31. Three hogs, each weighing between 150 and 175 pounds, ran out of a ditch and into the road in front of a car driven by X. The car was seriously damaged, and the passengers injured. The owner of the hogs claims damage for their injury. However, as a result of a trial, the owner of the car was awarded damages in an amount of approximately $400. What kind of insurance would cover liability for damage caused by hogs?
32. At one time there was a controversy between radio broadcasting interests and the American Society of Composers, Artists, and Publishers. Radio interests did not renew their contract with A.S.C.A.P. because of a disagreement on royalties. The radio corporations made use during the dispute of music on which copyrights had expired and some new pieces. The radio interests sought insurance to relieve the apprehension of advertisers and artists that they might lay themselves open to damage claims if A.S.C.A.P. copyright music should inadvertently be used. Do you believe this to be an insurable risk?
33. Professional liability policies, ordinarily known as "malpractice liability," were written to cover bodily injury growing out of error or mistake committed, or alleged to have been committed, by a professional practitioner in the practice of his profession. It can readily be understood that there is a grave risk in the case of physicians, hospitals, druggists, and other like practitioners. Discuss the extension of professional liability to include lawyers and morticians.
34. The Blank manufacturing plant loads its product on a spur track built for its use. The railroad before building the track required the party, for whose convenience it was constructed, to obligate itself to hold the railroad harmless for any claim or loss arising out of injuries to persons or damage to property due to the use of existence of the siding.

    While operating a train on the siding, a brakeman of the railroad was so severely injured that his leg was amputated. Does the agreement by the railroad and the manufacturing plant have the effect of holding the manufacturer liable for such an accident, and, if so, can the manufacturer protect himself through the agency of insurance?

Chapter XXXII

ACCIDENT AND HEALTH INSURANCE

TIME as an Asset. Life insurance contemplates provision for dependents in case of the death of the insured. Accident and health insurance provides indemnity to the insured for time lost because of accident or illness. Benefits are also usually paid when death is a result of the accident. Not only is the loss of time from productive enterprise the source of loss to the sick or injured insured, but the cost of care and necessary medical attention adds to the amount of the loss.

Accident and health coverages serve as an admirable point of transition from casualty to life insurance. The coverage is written by both life and casualty companies. The emphasis placed upon this form of coverage by the casualty insurers is responsible for the tendency to regard it as a division of casualty insurance. It is, in fact, the oldest of the casualty lines.

A comprehensive study of the accident and health business in the United States was carried on for the Social Security Board under the direction of Dr. Ralph H. Blanchard of Columbia University. When the study was initiated in 1942, it was found that there was no current list of carriers writing accident and health insurance. After considerable research it was found that 619 carriers were writing some form of the business. It was determined that 234 companies, representing 60 per cent of the number of accident and health insurance companies in business in 1942, wrote more than 90 per cent of the premiums. Of these companies, 80, or 34 per cent, were accident and health specialists; 72, or 31 per cent, were multiple line casualty companies; 77, or 33 per cent, were life companies; and 5, or 2 per cent, wrote reinsurance.[1] It is apparent, therefore, that although accident and health insurance is regarded as a casualty line the premium income is about equally divided between casualty companies, life companies, and companies specializing in the line.[2]

[1] Blanchard, Ralph H., *Survey of Accident and Health Insurance*, Bulletins No. 2, and 3, Bureau Memorandum No. 62 (Washington, D.C.: Social Security Board, 1945), p. 3. See also Bulletins No. 4, 5, and 6, published August, 1946.

[2] "Production-wide, accident and health premiums passed the 600 million mark in 1944, setting the pace in premium volume in the casualty field and topping the nearest

The Policy. There is no standard accident or health policy; competition has brought scores of contracts onto the market. One class of competition tends to broaden the coverage. In such cases, emphasis is placed upon the protection afforded rather than upon the premium charged. If emphasis is placed upon the premium, which is particularly low, the coverage under the contract may be expected to be limited. In this field, as in others, it is unreasonable to expect to get more than that for which payment is made.

The nearest approach to a standard policy is to be found in the requirements laid down in the standard provisions acts, now adopted by most states. Under the requirements set forth in these acts, designated provisions must be incorporated in every personal accident and health policy issued. Certain of these provisions are mandatory, while others are permissive. They have for their purpose the effecting of a reasonable degree of uniformity in policies, and the phrasing of important conditions in such a way as to make them understandable. They serve to eliminate the confusion and misunderstanding that attended settlements of claims when it was possible to write obscure limitations and exclusions into the contract. The conditions of the policy are usually grouped in two sections. The first covers the subject matter required to be expressed in the terminology of the standard provisions. The second section, headed "additional provisions," further outlines the extent of the coverage offered.

Standard Provisions. The standard provisions are concerned with operating conditions and are to be distinguished from the benefit provisions of the policy. Among other things, they provide that policies must be approved by the insurance department of the state of issue and that all exceptions in the policy must be given the same prominence as the benefits.

Briefly summarized, the standard provisions cover the following situations. First, if an insured changes his occupation to one more hazardous than that reported at the time the policy was written, it is

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casualty line competitor, workmen's compensation, by some 10 millions. This 1944 total is nearly double that for 1941 and is over six times the premium volume of 25 years ago. It is larger than the total for all casualty premiums in 1920. More significant, however, is the increase in the number insured. It is estimated by the Research Council for Economic Security that only four million persons were covered by accident and health insurance in this country 25 years ago. By the end of 1944, the number insured had increased to 40 million, with most of the growth occurring during the past ten years. Thus, while volume has increased some six times since 1920, the number insured is ten times greater today" (*The Standard*, October 12, 1945, p. 3).

provided that he shall secure that indemnity which the premium paid would have secured him on the basis of the rate for the more hazardous occupation. In other words, if the risk is changed, the policy is not voided, but the insured secures the protection that his premium will buy. The second condition has to do with the application and provides that no statement made by the applicant and not included in the policy shall void the policy or be used in any legal proceedings thereunder. It is further provided that no agent has authority to change the policy or to waive any of its conditions, and that changes to be valid must be approved by an executive officer of the company and endorsed on the policy. The third provision treats of the subject of default and provides that if default is made in payment of the agreed premium, the policy may be reinstated by the subsequent payment of the premium, but only to cover loss following the reinstatement. The fourth provision has to do with notice and provides that in the event of an injury upon which a claim is based, the company must be notified in writing within twenty days, except in the event of accidental death, when the company must be notified immediately. It is provided that notice may be given either to the company or to an authorized agent, and that failure to give notice does not invalidate a claim if it can be shown that it was not reasonably possible to give notice as required by the policy, and that notice was given as soon as was reasonably possible.

Upon the subject of a proof of loss, the standard provisions obligate the company to furnish the claimant such forms as it usually requires. Failure to furnish forms within fifteen days after notice relieves the insured of any obligations to submit a formal proof. When proof is required, it must be furnished to the company within ninety days after the termination of the period of disability, or within ninety days of the date of the loss. If the law of the state makes any provision contrary to the provisions in the policy, with respect to the limit of giving notice of claim or furnishing proof of loss, the policy provides that its terms are extended to agree with the minimum period permitted by the law.

During the pendency of a claim, it is provided that the company shall have the right and opportunity to examine the insured as often as may be reasonably required. It may also make an autopsy in case of death, unless forbidden to do so by law.

Indemnities provided by the policy for loss of time on account of

disability are payable at the expiration of each four weeks during the period of disability. Other indemnities provided are payable immediately upon the receipt of the proof. All indemnities are payable to the insured; with loss of life, they are payable to a beneficiary if named, and otherwise to the estate of the insured. The consent of the beneficiary is not a requisite to a surrender or an assignment of the policy, to a change of beneficiary, or to any other change in the policy.

It is provided that no action at law, or in equity, shall be brought to recover under the policy prior to the expiration of sixty days after the proof of the loss has been filed, and no action at law may be brought unless brought within two years from the time the proof of loss is required.

The company may cancel the coverage at any time upon delivering a written notice to the insured, or upon mailing it to his last address as shown by the records of the company. A return premium amounting to the unearned portion of the premium actually paid by the insured is required. Such a cancellation can in no way prejudice any claim pending at the time. There is no provision for cancellation of the policy by the insured unless he changes his occupation to one more hazardous than that stated in the policy. In this instance, upon notice in writing by the insured, and upon surrender of the policy, the insurance may be cancelled with a return of the unearned premium. However, it is the custom of companies writing accident insurance to cancel existing policies freely upon the request of the insured.

Important optional conditions provide that if the insured carries another policy covering the same risk without notice to the insurer, the company may pay only a pro rata share of the claim. Another such condition provides that if the aggregate benefit for loss, other than the loss of time in concurrent policies of the same company, exceeds a designated sum, the excess insurance shall be void. In such a case, the insured is entitled to a return of premium on as much of the insurance as is excess.

Additional Provisions. Certain of the important additional conditions have to do with the matter of definitions. The word "beneficiary" used in the policy is defined as "that person so named in the application or any person subsequently substituted therefor." The

term "injuries" is defined as "bodily injuries effected as described in the insuring clause." The insured's occupation and duties are described, as well as his occupation by classification. The principal sum payable in accordance with the policy terms is indicated, as well as the weekly indemnity and the premium for the policy term.

It is customary to provide that the policy be issued in consideration of the payment of the premium, as well as the statements made in the application. A copy of the application is endorsed upon the policy and made a part of the contract.

Another important clause usually found in accident policies provides that the insurance shall not cover accident, injury, disability, death, or other loss caused by bodily or mental infirmity, ptomaines, bacterial infections, or by any other kind of disease. To the stipulation regarding bacterial infections an exception is made in the case of pyogenic infections that occur simultaneously with and through an accidental cut or wound. The accident policy further provides that there is no coverage for any kind of disease, though there is usually a provision covering hernia. Some forms provide that there shall be no coverage for hernia; others, that in the event of any disability caused by hernia as the result of an accident, a single payment shall be made.

Suicide is not regarded as an accident, but as an intentional act. Accordingly, it is customary to exempt loss which is the outgrowth of suicide or any attempt thereat, regardless of whether the insured is shown to be sane or insane. It is also usual to exclude loss occasioned by war or act of war. Likewise injuries, fatal or otherwise, sustained by the insured as an incident to aviation or aeronautics are not covered. The condition relating to aviation may be excluded by attachment to the policy of an air-travel rider. This is ordinarily attached to the policy without an additional charge but limits the extent of the coverage to accidents sustained while the insured is riding as a passenger for hire in a properly licensed air vehicle, driven by a licensed pilot upon a regularly established air route.

A final provision excludes coverage when the loss is the outgrowth of accident, injury, disability, or death caused directly or indirectly by medical or surgical treatment. This exclusion does not apply in the case of a surgical operation made necessary solely as a result of injuries covered by the policy. To bring a loss within the terms of

a policy when the loss is the outgrowth of a surgical operation, a time limit is stipulated, within which such an operation must be performed. Ninety days is the time usually indicated.

Benefit Provisions. Under the section of the policy treating of benefits, there is a wide range in the coverage afforded by the different types of policies offered. Some of the more important clauses to be found under the classification of benefits include: (*a*) death benefits, (*b*) dismemberment, (*c*) total disability, (*d*) partial disability, (*e*) elective indemnities, (*f*) double indemnities, (*g*) blanket medical benefits, (*h*) limited medical benefits, and (*i*) identification.

Insuring Clause. While the insuring clause in most policies follows the same general form, a considerable difference in the coverage is effected by slight changes in the wording. Following is a widely used wording of the clause:

> The . . . . Insurance Company, does hereby insure . . . . against loss resulting directly and independently of all other causes, from bodily injuries effected during the term of the policy solely through accidental means.

In the foregoing clause the term "accidental means" requires special notice. There can be no question that the intent of the policy is to cover losses that are the results of accidents and nothing else. It must be pointed out, therefore, that unforeseen results of an action that is intended and carried out in accordance with the intent of the person performing the act is not within the scope of the coverage. To constitute an accident there must have been some event both unexpected and beyond the control of the injured party. This difference is illustrated by the following example. A man piling wood strains his back and, as a result, is unable to work for two weeks. In piling the wood he did exactly as he intended to do, though the injury to his back was a consequence. There was no accident; therefore, such an injury would not fall within the protection afforded by the insuring clause cited above. If, while piling the wood, the man had slipped and injured himself or dropped a piece of wood with a resulting injury, he would not have done as he intended. There would have been an accident, and the loss, therefore, would have been the outgrowth of an injury effected through accidental means.

There are policies in which the insuring clause reads "through external, violent, and accidental means." Obviously, this clause is

considerably more restricted than the one quoted. The words "external and violent" have been eliminated from most of the policies now written. It is well to recognize, however, that their use tends considerably to narrow the coverage.

The phrase "independently of all other causes" is very broad and if literally interpreted might nullify the intent of the contract. For this reason court interpretations have tended to favor the insured as against the company. As a consequence, it is now the rule that if a disease follows an accident as a natural or inevitable consequence, the accident is regarded as the cause of the injury or death. The situation is not changed if the insured is afflicted with the disease before the accident, provided the accident produces results otherwise unlikely. The courts have definitely held that an injury that might naturally produce death in a person in a poor state of health is the cause of his death if he dies by reason of it, even if he would not have died had his previous health been different. In other words, a man suffering from a weak heart might die as the result of an accident which would not kill a man with a normal heart. In such a case, death is held to be a consequence of the accident.

The reference in the insuring clause to the policy term serves to limit coverage for loss to accidents that occur while the policy is in force. Any loss that may develop during the policy term that is the outgrowth of an accident that occurred before the inception date of the policy and before the premium was paid is not covered.

Death Benefits. The amount indicated in an accident policy as payable to the beneficiary of the insured in the event of accidental death is designated as the "principal sum" or "principal amount." Not all accident policies are written with a principal sum, though such a sum is designated in most policies.

Policies as written define conditions essential to the establishment of a loss by accidental death. The death must occur within 90 days from the date of the accident claimed to be the cause of the death; or, if the insured is totally disabled within 20 days of the accident and if total disability continues until the time of the death, the death is covered if it occurs within 200 weeks. If there is no weekly indemnity provided in the policy, the 90-day rule is followed.

Dismemberment or Loss of Sight. If the policy provides a weekly indemnity for disability, and coverage for dismemberment and loss of

sight is provided, it is customary to express the indemnity for such losses in a multiple of the weekly indemnity. Following is an example:

POLICIES PROVIDING WEEKLY INDEMNITY

For Loss of:	Sum Equal to Indemnity for:
Both hands, both feet, or sight of both eyes	200 weeks
Hand and foot	200 weeks
Hand or foot and eye	200 weeks
Hand or foot	100 weeks
Sight of one eye	65 weeks
Thumb and index finger	50 weeks

If no weekly indemnity is provided, it is customary to indicate the indemnity for dismemberment and loss of sight in terms of the principal sum as follows:

POLICIES NOT PROVIDING WEEKLY INDEMNITY

For loss of:	
Both hands, both feet, or sight of both eyes	Principal sum
Hand and foot	Principal sum
Hand or foot and eye	Principal sum
Hand or foot	½ principal sum
Sight of one eye	⅓ principal sum
Thumb and index finger	¼ principal sum

When the policy makes provision for the loss of a bodily member, it does not follow that, in order to recover, the entire member must actually be severed from the body. If as a result of an accident the member becomes practically useless, even though there has been no amputation, the member is lost within the meaning of the policy, and the insurer becomes liable.

Total Disability. When indemnity is provided in the event of total disability, such disability must arise within a specified time after the accident, usually twenty days. The weekly indemnity provided is ordinarily expressed to be payable if the injuries shall "wholly and continuously disable the insured and prevent him from performing any and every duty pertaining to his occupation."

A policy so written provides a weekly indemnity according to its terms if the insured, because of the injury, is unable to perform any of the customary duties of his occupations. When, however, he is able to attend to some of his usual duties, his injury does not amount to total disability. If the insured is able to visit his store or office but

is able only to perform trivial acts, such performance does not change the status from total disability. An insured is not required to attend to his duties if doing so is the cause of great pain, if it is at the risk of his health, or if common prudence indicates the contrary. If, however, the insured is able to conduct his business, even though at some inconvenience, the disability is not total. From the foregoing, it is apparent that an injury sufficient to warrant a claim for total disability will not be the same in the case of every insured but will depend largely upon the nature of the insured's occupation.

Partial Disability. If the insured is able to perform certain of the duties of his occupation, but not all of them, he is entitled to such indemnity as the policy provides for partial disability. Such disability must manifest itself within a specified time following the accident, usually twenty days, or it may follow immediately a period of total disability. If this provision is made a part of the policy, a percentage of the weekly indemnity is payable for a specified number of weeks during the period of partial disability.

Elective Indemnity. If the insured exercises his option under the elective indemnity clause, he makes an immediate settlement as more to his advantage than would be the weekly payments during the period of disability. Following is a schedule taken from an accident policy, indicating the nature of the options offered under this clause:

For Loss by Removal:	
Of one or more entire toes	$400
Of one or more fingers (at least one entire phalanx)	300
For Complete Dislocation of Joints:	
Hip	600
Knee (patella excepted)	300
Bone or bones of foot (other than toes)	300
Ankle	300
Wrist	250
Elbow	200
Shoulder	150
One or more fingers or toes	50

For Complete Fracture of Bones:	
Skull (both tables)	$650
Thigh (shaft)	600
Arm, between elbow and shoulder (shaft)	600
Pelvis	500
Shoulder blade	400
Leg (shaft)	400
Knee cap	400
Collar bone	300
Forearm, between wrist and elbow (shaft)	300
Foot (other than toes)	250
Hand (other than fingers)	250
Lower jaw (alveolar process excepted)	150
One or more ribs, fingers, or toes	100

Double Indemnity. Accident policies frequently provide for double indemnity in the event that the injuries are sustained under specified circumstances. Among those circumstances frequently men-

tioned are: (*a*) while the insured is a passenger in or upon a public conveyance provided by a common carrier for passenger service (including the platform, steps, or running board of such conveyance); (*b*) while he is a passenger in an elevator car, provided for passenger service only, other than elevator cars in mines; or (*c*) while he is in a building whose outer walls collapse, or in a building that burns, if he is therein at the time of the collapse or commencement of the fire. Double indemnity is also granted if injuries are received: (*a*) by the explosion of a steam boiler; (*b*) by a hurricane or tornado; or (*c*) by a stroke of lightning.

Medical Expenses. The coverage for medical expense, when it is offered, varies with the different policies. The most complete coverage is written with a blanket clause. Under its terms, if the insured within a time limit set by the policy requires treatment by a physician or surgeon, hospital confinement, or employment of a trained nurse as a result of injuries covered, the company is obligated to pay, in addition to any other indemnity to which the insured may be entitled, the actual expense of such treatment up to a designated sum or to the policy limit. This broad form is of comparatively recent development and does not appear in all accident policies. Under the limited forms it was found that in case of serious injuries the contracts furnished inadequate protection. In certain cases this had a tendency to defeat the actual purpose of the contract. The blanket clause has the effect of preserving the income protected by the insurance from depletion due to the inroads made by medical services and hospital care.

Even if the broad coverage is not used, the policy may still provide for the payment of hospital, medical, and surgical expenses. A satisfactory limited coverage provides an increase of 50 per cent in the weekly indemnity when confinement to a hospital is necessary, or if the injury is of such a nature as to require the services of a graduate nurse. Policies so written may provide, in addition, a schedule of surgical indemnities. These indemnities grant a lump sum payment in the event that the injuries covered by the policy are of such a nature as to require an operation. This surgical indemnity is payable in addition to other indemnities provided in the policy. The policy may further provide that if an injury is of such a nature as not to result in death or disability, or necessitate an operation, but as to require treatment by a physician or a surgeon, the company will pay

the actual expense of such treatment, limited by the amount of a single weekly indemnity.

Identification. This coverage makes provision for bringing notice of the accident to the attention of the relatives or friends of the insured if, because of injuries, the insured himself is unable to do so. Under a form widely used the company obligates itself upon the receipt of a telegram or other message indicating the nature of the accident, to transmit the information immediately to the relatives or friends of the insured. The company further undertakes, subject to a limit of $100, to defray the expenses necessary to put the insured in the care of relatives or friends. The operation of this condition is dependent entirely upon the physical inability of the insured. It does not undertake to pay expenses of communication and transportation except when the insured is so incapacitated that he cannot attend to these matters himself.

Miscellaneous Provisions. Some policies provide special indemnities if the accident occurs under specified circumstances. Frequently indemnities are doubled, tripled, or further increased. Rewards are provided for identification, and sometimes benefits are accumulated as the policy is renewed.

Some of these benefits take on the characteristic of "window dressing." The chance of securing the additional benefit is often extremely remote, yet it is frequently held out to the insured as an attractive feature to encourage him to buy the particular contract.

Restricted Coverages. There are three important forms of accident policy, each of which is designed to cover a particular risk and not to afford general income insurance protection. These are: (*a*) the ticket accident policy, (*b*) the automobile policy, and (*c*) a death or dismemberment policy. The ticket accident policy provides payment for loss of life and limb, as well as for loss of time as a result of injury by accidental means. The policy provides an additional indemnity if the injury is sustained while riding as a passenger in or upon a public conveyance provided by a common carrier for passenger service and propelled by mechanical power on land or water. A peculiar feature of the ticket accident policy is found in the fact that it may be issued for a day, a week, several days, or in periods of 30, 60, 90, or 120 days. Policies are usually obtainable at the ticket office of the railroad station or other carrier. These policies contain a wide range of exclusions. Disappearances are not covered, and there is no

coverage if there is no visible wound or contusion of the body of the insured. The policy does not provide for medical treatment. It is important that the insured carefully familiarize himself with the protection afforded by this type of policy.

The automobile policy is a limited form providing protection only in the event of loss resulting from injuries sustained in automobile accidents. The coverage is effective while the insured is riding, adjusting, repairing, or cranking a car. Accidents which are the consequences of the burning or the explosion of a car are covered, and the insured is protected if he is struck or run down by an automobile. This policy does not cover if the insured is operating or driving the car for a wage or profit. Because of this, chauffeurs and mechanics do not find protection under the policy. There is also an exclusion for accidents if the insured is riding in certain types of vehicles termed to be hazardous, such as a truck, an ambulance, a patrol car, or a piece of fire apparatus. The coverage also excludes accidents which are the outgrowth of racing.

The death or dismemberment policy provides insurance only in case the insured is killed or dismembered as a result of an accident. There are no weekly indemnity, medical indemnity, or other benefit features emphasized in the usual accident policy. This type of policy is particularly attractive to executives and others whose income will not stop in the event of an illness, or in the event of an accidental injury. It is widely used by executives of railroad companies and others whose duties involve frequent travel.

Health Insurance. In contrast to accident insurance, health insurance provides indemnity for loss resulting from sickness or disease. This policy is designed to supplement accident insurance so that income may be continued, whether disability originates from an accident or from illness. Under the insuring clause, indemnity is provided for loss resulting, independently of all other causes, from disease contracted during the term of the policy. To establish a loss, therefore, there must be disability, the result of disease only, which has been contracted during the policy term. The disability may be total or partial, and, if total, it may be temporarily total or permanently total.

The health contract in its important clauses follows as far as possible the accident contract. The application and consideration

clauses are alike. The term, cancellation, standard provisions, and additional provisions are the same in their essentials.

The benefits provided by the policies offered by the various companies vary and may include a weekly indemnity for total or partial disability, hospital and graduate nurse benefits, as well as special surgical provisions.

Classifications of Policies. There is a wide range in the coverage offered under the health policy. The definition of "total disability" under one policy may differ entirely from that of "total disability" under a second. For example, one contract may require house confinement as a condition precedent to total disability, while another may define the condition as "inability on the part of the insured to perform any of the duties of his occupation." A third policy is even more limiting in its terms and defines "total disability" as the "inability to perform the duties of any occupation whatsoever." In some cases a weekly indemnity is payable immediately upon incapacity, and in others a waiting period of total disability must elapse prior to the payment of benefits. There are policies which cover against disability from special hazards and others which cover certain losses from all hazards. Because of these differences it is customary to classify health policies in two ways. The first classification indicates whether or not the policy is written with the house-confining provision. The second classification indicates whether or not the policy is written with a waiting period. Having settled these two points, one must determine, first, the length of the waiting period and, second, the special benefits provided by the policy.

In the Blanchard survey of accident and health insurance, previously noted, the following nine classifications of contracts are made:[8]

1. *Commercial.*—Premiums are usually paid annually but may be paid semiannually or quarterly. This category includes *semicommercial* insurance and insurance written by or equivalent to that written by members of the International Federation of Commercial Travelers Insurance Organizations. *Commercial* is perhaps the best-known type of accident and health insurance and exceeds any other type of individual coverage in the volume of premium payments. It is bought largely by professional and salaried persons.

2. *Hospitalization and Medical and/or Nursing Care (Excluding Group).*—Provision *under separate contracts* for hospital, medical and/or nursing care,

[8] Blanchard, *op. cit.*, p. 3.

whether on a fixed or reimbursement basis, but not for other benefits except minor funeral or similar benefits. Contracts written by carriers writing only *hospitalization* or *medical care* insurance are excluded from this survey.

3. *Group (Including Blanket).*—Insurance under a contract with employer, organization, or individual, as policyholder, covering employees, organization members, or individuals, other than the policyholder, as insured or beneficiaries.

4. *Noncancellable (Broad Coverage).*—Insurance under contracts *renewable* to the age 50 or older at the insured option and without right of cancellation by the insurer, at substantial annual premiums. For carefully selected professional and salaried persons who are high-grade risks, written largely by carriers specializing in this type of business.

5. *Franchise (Including Railroad Business).*—Insurance under contracts sold to individuals under an arrangement with an employer for access to his employees and usually for deductions of premiums from pay roll, or written on members of an association. Individual contracts are written, but underwriters consider the characteristics of each employer's group of employees, or of each association.

6. *Monthly Premium.*—Moderate-priced insurance for policyholders who are somewhat above the lowest income group but find it easier to pay premiums monthly.

7. *Weekly Premium Industrial.*—Written largely on the lower income groups in the manufacturing districts of metropoliitan areas. In the southeastern States, written widely and almost wholly for Negroes.

8. *Limited.*—Insurance covering only specified accidents and/or diseases, or limiting benefits for specified causes of disability or in specified circumstances and, in general, policies selling for annual premiums of $15 or less. Includes automobile accident, automobile club, newspaper, travel accident, civilian war injury, aviation, travel ticket, and similar business.

9. *Miscellaneous.*—Includes installment purchase insurance and other special types not included in the preceding classes.

House-Confining Disability. When under the terms of the contract it is provided that the insured must be confined to the house in order to collect the full indemnity, the insured will not collect the full amount of the weekly benefit, even though totally disabled, unless this total disability makes house confinement necessary. The non-house-confining policy allows the full amount of the weekly indemnity on the basis of total disability alone and makes no requirement with regard to confinement.

Disability under the health policies falls into three general classifications: (1) temporary total disability, (2) permanent total disability, (3) partial disability. Temporary total disability exists when the insured, because of disease, is wholly and continually disabled and prevented from performing any of the duties pertaining to his occupa-

tion. When the policy is of the house-confining type the insured gets the full weekly indemnity only while so confined. He receives partial indemnity when house confinement is unnecessary, even though he may still be wholly incapacitated. Under the non-house-confining type the indemnity is paid while the insured is so disabled as to prevent him from performing any of the duties of his occupation. The weekly benefits for temporary total disability are paid for a period designated in the policy. The usual period for such payments is fifty-two weeks.

Permanent total disability is said to exist if the insured loses permanently the use of both hands, both feet, one hand and one foot, or the sight of both eyes, with the result that the insured is unable to engage in any occupation or employment for wage or profit. Under some policies the permanent loss of speech or hearing constitutes a permanent disability.

Policies differ in their provisions for permanent total disability. Some provide for the payment of the full weekly indemnity for a period of fifty-two weeks, to be followed by a reduced benefit as long as the insured lives and suffers the total disability. Some policies provide for a lump sum settlement in the event of certain losses, while others provide for full weekly indemnity payable until the principal amount of the policy is exhausted. A common limitation is one hundred weeks. Following is an example of total disability schedule:

For Loss of:	Sum Equal to Weekly Sickness Indemnity for:
Sight of both eyes	100 weeks
Use of both feet and hands	100 weeks
Use of both hands	100 weeks
Use of both feet	60 weeks
Use of one foot and one hand	60 weeks
Use of one foot	50 weeks
Use of right hand	50 weeks
Sight of one eye	50 weeks
Speech, or hearing of both ears	30 weeks
Use of left hand	25 weeks

Partial Disability. Many companies do not recognize partial disability under the health policy. It can readily be seen that the dividing line between no disability and partial disability is difficult to locate. However, some companies do make provision for partial disability, though when provision is so made it covers only partial dis-

ability immediately following a period of total disability. The test of partial disability rests upon the inability of the insured to perform a part of his work. Some policies provide that if the insured is disabled and prevented by sickness from performing at least one-half the work essential to his duties, he is entitled during such period of partial disability to one-half the indemnity payable for total disability. The policy usually sets a limit to the period for which the insured is entitled to partial disability. A usual limit is twenty consecutive weeks. When provision is made for partial disability following total disability, a usual limit is fifty-two weeks for the total and partial disability combined.

Surgical Indemnities. When this provision is found in the policy, an additional indemnity is provided in case the insured contracts a disease covered by the policy, by reason of which an operation is necessitated within a designated number of days from the commencement of the period of total disability. The period is usually ninety days. A schedule of amounts is ordinarily provided in the policy, and the amount indicated is payable in addition to other indemnities. The following partial list indicates the nature of a schedule of indemnities for operations:

ABDOMEN—Cutting into abdominal cavity for diagnosis or treatment of organs therein	$200
AMPUTATION OF:	
Thigh	150
Arm, leg, or entire foot	100
Forearm or entire hand	50
Thumb, finger, or fingers (at least one entire phalanx)	20
Toe or toes (at least one entire toe)	20
CHEST—Cutting into thoracic cavity for diagnosis or treatment of organs therein	100
EAR, NOSE, OR THROAT:	
Any cutting operation	20
EXCISION—Removal of:	
Shoulder or hip joint	200
Knee joint	150
Elbow, wrist, or ankle joint	100
Coccyx	20
EYE—Removal of	$100
Any cutting operation on the eyeball	20
GOITER—Cutting operation for radical cure, arterial ligation excepted	150
HYDROCELE—Incision and treatment of sac	50
INCISION for drainage	10
INFLAMMATION OF JOINT—Incision into joint	50
MASTOIDITIS—Cutting operation for removal of diseased bone	100
PARACENTESIS—Tapping of:	
Abdomen	50
Bladder	30
Chest	30
Ear drum	20
Hydrocele	20
Joints	20

Hospital Indemnity and Nurses' Fees. When provision is made

in the policy for hospital expenses, the amount is paid on the basis of an increase in the weekly indemnity specified in the policy. A usual clause provides for an additional indemnity of 50 per cent for the period of hospital confinement, which is limited to twenty weeks.

It is customary to provide the indemnity indicated for hospitalization if the insured suffers a disability that necessitates attendance by a graduate nurse within ninety days from the commencement of the disability. Nurses' fees are not as a rule allowed if hospital indemnity is paid.

Waiting Period. A policy written with a waiting period is the same in principle as any coverage with a deductible feature. In the case of a health policy, it will be recognized that almost every insured during the policy term will suffer short periods of disability involving financial loss of no consequence. If all of these short periods of disability involve loss payments under the health policy, obviously the premium charge will have to be high. Through the establishment of a waiting period in the policy, losses involving disability for a short time are excluded from coverage. At the same time, the policy provides indemnity for illnesses extending over a long period of time and involving expensive care and treatment.

Two weeks is a customary waiting period, but the time may be varied in different policies from one to several weeks. The longer the waiting period provided for in the policy, the lower the premium. Consequently, a policy containing a reasonable waiting period will protect the insured in the event of serious illnesses at a more reasonable cost than if full coverage is provided.

Aviation. With the advent of commercial aviation the effect of the use of air transportation upon accident coverages was naturally brought to the attention of insuring companies. Most companies now recognize that commercial aviation is an established means of transportation and are willing to extend coverage under the accident policies if the insured is making use of regularly established passenger lines.

Territorial Limits. Whether or not the policy specifically limits coverage to the United States, it is the intent of most accident and health insurers not to accept risks outside of the United States except under special conditions.

If an insured is undertaking a particular trip for business or pleasure and insurance is required, it is customary for the insuring com-

pany to require a statement covering the important features of the proposed trip. Among the requirements are the date of departure and return, the countries to be visited, the purpose of the visit, and the parts of the countries in which travel is contemplated. Provided the conditions of the journey and the countries to be visited meet with the approval of the insuring company, policies may be issued. As an underwriting practice, a period of time to be covered by the journey is required not to exceed a designated limit.

Prohibited Risks. If the physical condition of the applicant for an accident or health policy, as brought out by his application or a medical examination, is for any reason unsatisfactory, the risk is not insurable. While the insurance companies accept or reject risks at discretion, certain affections so regularly result in rejection that persons suffering from them are regarded by most companies as prohibited risks. A complete list of such affections would hardly be the same for different companies. Among those ordinarily accepted, however, as sufficient to make the risk uninsurable are: angina pectoris, apoplexy, arteriosclerosis, blindness of both eyes, disease of brain, Bright's disease, cancer, diabetes, epilepsy, heart disease, locomotor ataxia, neurasthenia, paralysis, pernicious anemia, spinal cord diseases, tuberculosis, and vertigo or fainting spells.

Policy Term. Premium rates for accident and health insurance are quoted on the basis of a one-year term. Premiums may be paid, however, subject to the particular rules for each company, on an annual, semiannual, or quarterly basis.

A particular feature of accident insurance is to be found in the willingness of insurance companies to write short-term insurance. An insured, therefore, who for some reason or other requires coverage for a period of one, two, or several months may secure it.

Health policies are not issued for short terms, nor are some of the limited policies, such as the automobile policy. For those requiring short-term accident coverage, provided the policy is broad enough to meet the needs of the insured, the accident ticket provides the simplest means for effecting the insurance.

As will presently be noted, noncancellable policies are also written.

Rates. Four important factors enter into the computation of the premium of an accident or health policy: (1) occupation, (2) sex, (3) age, and (4) the amount of indemnity.

Accident and health manuals have an elaborate system of classification of occupations. On determining the occupation of an applicant who is otherwise insurable, one refers to the manual, which will give the premium charge for a unit of weekly indemnity and the principal amount.

The factor of age is considered only to a limited degree. There are brackets between which risks are acceptable. In certain classifications, risks will be acceptable between the ages of eighteen and fifty-nine, and in other classifications a higher premium charge is made above the age of fifty-five. When male and female risks are accepted for insurance, different rating tables are provided for each group.

Of all these factors, the classification as to occupation is controlling. The premium charge advances sharply from the lower rated groups to the higher, and some of the more liberal policies are not issued at all to those employed in the more hazardous occupations. As a matter of policy, all companies refuse to accept either male or female risks engaged in any work or business involving a direct occupational disease hazard. The same is true if the applicant for insurance is employed under conditions held to be either unsanitary or unhealthy. These risks are classed as prohibited for occupational reasons. Included in the group are lead workers, pottery employees, or workers whose occupation requires the use of such substances as arsenic, mercury, wood alcohol, acids, poisonous gases, or chemicals. The prohibition also extends to furriers, tanners, and those engaged in dusty trades, such as wood workers or granite workers.

Noncancellable Policies. Accident and health policies have been written under a noncancellable form. These policies are essentially the same as the corresponding cancellable forms. The important difference to be found in the noncancellable policy is the provision that the insured may renew his policy at his option from year to year, and the company may not refuse renewal. Many companies do not use this form at all, and, when written, risks are accepted with great reluctance. The volume of accident and health business written under noncancellable forms is comparatively small, but from the standpoint of the insured the form has a strong appeal.

Life insurance companies have been writing noncancellable life indemnity accident and health policies which pay a monthly income for life for total permanent disability. Because of an unfavorable experience with this type of business, these companies too have

tended not only to restrict the early and more liberal benefits provided, but as well to withdraw from this type of business. Earlier policies offered permitted renewal to the age of sixty or sixty-five, with a waiting period usually of two weeks. The definition of total disability was broad and provided payments if the insured were incapacitated so that he could not carry on his regular occupation. The more recent tendency on the part of life insurance companies has been to substitute aggregate indemnity policies which limit benefit payments to an aggregate amount rather than monthly payments for life, and as late as 1935 only four companies continued to write indemnity for the duration of life in new policies. The coverage in connection with life insurance is a logical one, since life insurance contemplates total disability as a "living death."[4]

When noncancellable accident and health insurance was offered, it was recognized that the loss of earning capacity caused by total disability was quite as grave as the loss due to death of the wage earner. Because of difficulties of administration, the outgrowth of competition, and a flood of dishonest claims in periods of depression, the experience of the insurance companies in this field was just short of disastrous. The withdrawal of companies and the curtailment of benefits from a social point of view is unfortunate. This field is now receiving the attention of the Social Security Board with a view to including total disability as a basis for benefits under the Social Security Act. That the need exists for noncancellable policies covering accident and health in the field of commercial insurance can easily be demonstrated.

Group Accident and Health Insurance. There are a number of policy forms issued by various insurance companies covering as a group all the members of an organization. Employees, recognizing the benefits of workmen's compensation and realizing that the compensation policy provides protection to a workman only while engaged in his occupation, have sought to extend the protection beyond the limits afforded under the compensation policy. To this end group accident and health policies are available, which provide indemnity to employees for accident or sickness not otherwise covered by the compensation policy. A wide variety of group accident and

[4] Huebner, S. S., *The Economics of Life Insurance* (New York: D. Appleton & Co., 1927), pp. 6–10.

health policies are offered, each designed to fit the needs of a particular organization or group of workers.

The usual weekly benefit under a group policy amounts to two-thirds of the weekly wages, with a limit of twenty-six weeks. The policy may be written with a smaller percentage of the weekly salary payable as the weekly indemnity, or it may be written with the weekly indemnity payable in the form of a fixed sum. When health coverage is provided there is usually a waiting period of two weeks, though indemnity for accidental injuries ordinarily begins with the date of the accident.

The premium is collected from the employer. The employer may pay it entirely, collect it from the insured in the form of a deduction from wages or salary, or arrange for a division of the cost between employer and employee. A contract is issued to the employer in the form of a master policy, and a certificate is issued to each employee as evidence of his insurance protection. Group insurance is issued after a survey of the plant or organization has been made, and the rates are dependent upon such features as occupational hazards, labor turnover, percentage of women employed, and the extent of coverage required by the insured.

Group accident and health policies are usually written to cover loss of time caused by nonoccupational injuries or sickness. This is true because occupational disabilities are, in the ordinary course, covered by workmen's compensation insurance. However, when occupational accident coverage is desirable, either because of the lack of a compensation law, or because the members of the group do not come within the operation of the law, occupational accident coverage may be written. There is also a form known as the "accidental death and dismemberment policy" which provides benefits only for accidental loss of life, limb, or sight.

Group accident and health policies are written for groups of fifty or more employees, and it is required that at least 75 per cent of all eligible employees in a group participate in the plan. Insurance is written for groups of less than fifty, but in such instances it is customary to require an increase in the premium charge. In the case of hazardous industries the premium is likewise increased, and in some instances, if the hazard is too great, companies will not accept the risk at all.

To provide complete protection under a group policy, there should be written a combination of the accident and health benefits, providing weekly indemnities for loss of time and the accidental death and dismemberment benefits, which are payments for accidental death or injury, together with the hospitalization benefits, presently to be noted.

Hospitalization Insurance. It has already been noted that provision for hospital confinement and other medical expenses has been included in certain of the accident and health policies. Because, in some instances, the costs for medical expenses and hospital care create a burden far in excess of the actual loss of income for the period of incapacity, a need was soon recognized for a policy providing hospital and medical benefits entirely separate from the usual accident and health combination, which provides as well weekly indemnity during the period of incapacity.

Hospitalization insurance became a matter of wide public interest following the organization of voluntary nonprofit hospital associations. In December, 1929, Baylor University Hospital at Dallas, Texas, entered into an agreement with 1,500 school teachers, each of whom was a member of a benefit society that provided benefits during a period of illness in return for a payment of $3.00 per semester per member. The plan attracted attention throughout the United States, and nonprofit hospitalization associations enjoyed a phenomenal growth.

Recognizing the need for hospital care in connection with group life insurance plans, a number of life insurance companies now offer group hospitalization benefits in connection with their group life insurance and group disability protection. Unlike some of the plans sponsored by the hospitals, the life insurance companies do not offer guarantees of hospital service but instead provide cash benefits toward the cost of hospital care.

It was a normal development that accident and health companies, recognizing in the continued expansion of voluntary hospital associations the need for hospitalization insurance, enlarged their field to provide hospitalization insurance. Accident and health companies now offer a wide variety of hospitalization-reimbursement forms, and these are offered both on an individual basis and on group policy forms.[5] In the case of group insurance, policies are written on a non-

[5] Indicative of a highly specialized policy in the field is a coverage offered paying up

contributory basis, with the employer assuming the full burden of the premium, or they are written on a contributory basis, requiring the employee to pay a part or, in some instances, all the cost. The group hospitalization-reimbursement form is written, as has already been noted, in connection with group life insurance and group accident and health insurance or it may be written as a separate and independent form of insurance. Under the group hospitalization form no medical examination of an insured employee is required, except that under the contributory forms an employee who fails to take advantage of the coverage within a month of being eligible is usually required to pass a medical examination at his own expense.

FOR REVIEW

1. In the scale insurable risks, what relative rating would you give to the importance of income?
2. Distinguish between the coverage afforded by the insuring clause of an accident policy which provides coverage against injury through "accidental means" and the insuring clause which reads, "accidental injuries."
3. The accident policy of B covers against injury or death sustained "solely and exclusively through external, violent, and accidental means." As a result of an automobile accident, B suffers serious internal injuries. Notwithstanding the use of the wording "external" in the insuring clause, why does the policy cover the accident?
4. X, who was sixty years old, died as the result of a heart ailment. There was a red bruise on the side of his leg, and the claim was made that the leg injury was the cause of his death. Have the claimants a case?
5. B, who was suffering from a long-standing case of heart trouble, just before he died carried a heavy door from one building to another. The exertion caused the wall of his heart to rupture. Is this an accident?
6. B, standing at the edge of a dock, fainted, fell into the water and was drowned. Was death caused by illness or by an accident?
7. B is working in the woods and accidentally cuts his foot with an axe. The injury is not serious, but due to loss of blood he is found in a cold and weakened condition. He is taken to a hospital, where his injury is treated, and he is found to have contracted pneumonia. No serious consequences are anticipated from the injury, but within a week death resulted from the pneumonia. What is the extent of liability under the accident policy?
8. B scratches his hand with a pin and about two weeks later dies of blood poisoning. Is his death due to accident or disease?

to $5,000 in benefits should the policyholder be stricken with poliomyelitis. The disease is very costly to treat. The policy covers all phases of "polio" treatment, doctor and hospital bills, special nurses, use of an iron lung, ambulance service, and even provides for transportation from one locality to another for further treatment, should it be recommended by the physician. The policy provides a strictly limited coverage and offers protection for the one disease only.

9. B's policy provides a flat sum for the loss of a hand. As the result of a gunshot wound B's hand was so injured as to make it useless, though amputation was not necessary and the hand itself was not, therefore actually lost. Is the insurer liable?
10. In an application for an accident policy, B stated that he was a college president. While sawing a board he cut his hand with a saw, and as a result of blood poisoning the member was amputated above the elbow. The insurance company denies liability on the ground that carpentry does not fall within the customary occupation of a college president. What is the position of the claimant?
11. B, a school teacher, decides during the summer months to study aviation. His accident policy exempts the insurer if the insured engages in a more hazardous employment. On the way to the aviation field, between the train and the field, B was killed in an automobile accident. The company denies liability on the ground of unauthorized employment. What is its position?
12. Y was sitting on his veranda with a dog in his lap. As a joke, somebody came from behind and pinched the dog's tail. The dog bit Y on the thumb. Blood poisoning set in, and two weeks later death followed. Is this an accident?
13. C, in an effort to commit suicide, cuts his wrist. Suddenly changing his mind, he bandages it. The injury is not serious, but two weeks later an infection develops, and it becomes necessary to amputate the arm. What is the position of the parties in this case?
14. The insurance contract of X excludes liability for intentional injuries inflicted by the insured or any other person. X is shot by B and killed. B is arrested as a murderer. B claims he fired at a deer. Why is the accident insurance company of X interested in B's defense?
15. M. P. meets with a serious accident at 3:30 P.M. on the day his accident policy expires. Is he covered?
16. B is unloading a truck, and as he lifts a heavy package his foot slips slightly on a piece of oily waste and he injures his back. In discussing the case with the insurance adjuster B denies having slipped, thinking this will be evidence of carelessness. What is the effect of this denial?
17. B's policy provided $10,000 indemnity if he was so disabled as to be prevented from engaging in *any* work or *any* business for compensation. B became deaf and, because of the nature of his business, he was obliged to close it out. It was contended that there were other occupations open to a deaf man, and the company, therefore, was not liable. In your opinion is the company liable?
18. Admitting that loss of time because of illness or accident is serious to the individual, taking the population at large, in your opinion is the average worker in grave danger of loss from this source?

PART V

LIFE INSURANCE

CHAPTER XXXIII

ESTIMATING THE LIFE RISK

DEFINITION. The life insurance policy is a contract of insurance in part only. Because of this fact, a consideration of the subject of life insurance requires the notice of certain principles and rules that apply only to this branch of insurance.

The insurance contracts considered up to this point have been agreements whereby the insurer, for an agreed consideration or premium, undertakes to indemnify the insured against loss or damage caused by the perils indicated in the policy. In the case of all forms of insurance, except life, the happening of the unfavorable contingency which gives rise to the loss is a matter of uncertainty. In life insurance the calamity insured against is death. Death is universal and certain. The uncertainty attendant upon death is the time of its coming.

Because the happening of the contingency insured against is certain (whereas, in other forms of insurance it is uncertain), life policies, unless written only for a term, must make provision for a certain payment. The uncertain element is to be found in the time when such payment must be made.[1]

In its simplest form, life insurance undertakes to protect the insured's family, creditors, or others against pecuniary loss which may be the outgrowth of the death of the insured. The contract embodies an agreement between the insurer and insured in which, broadly stated, the insurer undertakes to pay a stipulated sum upon the death of the party insured, or at some designated time to a designated beneficiary. Legal status has been given to the definition which indicates the life insurance agreement to be:

[1] The application of the principles of life insurance to property insurance have been worked out by Dr. Hans Heymann. The plan was first formulated by him in 1920, but it has been recently presented in comprehensive form in his book *Property Life Insurance* (New York and London: Harper & Brothers, 1939). The plan contemplates the accumulation of replacement funds for property through insurance with the result that at some time a capital sum is paid to an insured. This will be either at the time of physical damage to the property or because the property no longer has an economic life and must be replaced.

A contract by which the insurer, for a certain sum of money or premium proportioned to the age, health, profession, and other circumstances of the person whose life is insured engages that, if such person shall die within the period limited in the policy, the insurer will pay the sum specified in the policy, according to the terms thereof, to the person in whose favor such policy is granted.[2]

As a matter of theory, life insurance may be written by an individual or a corporation. As a matter of actual practice, the business of life insurance is almost always written by an insurer incorporated for the purpose. The consideration paid by the insured or insurant, as in other forms of insurance, is termed "the premium." The premium may be in the form of a single payment, or, as is more usually the case, it may be paid in yearly or smaller installments. The person to whom the insurance is to be paid is termed "the beneficiary," and the sum to be paid, the amount of insurance.

In addition to the life policy, which has as its purpose affording protection in the event of a premature death, the life insurance business has developed a second type of contract, termed "the annuity," which furnishes income protection during a period of old age when productive powers have diminished or disappeared.

The essential difference between life insurance and other forms of insurance designed solely to assume the burden of an uncertain peril is to be found in the fact that life insurance has, in addition to the function of protecting against uncertainty, the function of accumulation. A considerable part of the premium paid for life insurance represents a contribution on the part of the insured to a fund for investment to be administered by the insurer. Only so far as the life policy makes provision for the uncertainty of death or, expressed differently, provides indemnity for the unexpected destruction by death of the life as an agency of production, it coincides with other forms of insurance heretofore noticed. The establishment of an estate and its management and investment in the interest of the insured are features peculiar to the business of life insurance.

The Life Insurance Carrier. There are three classes of companies writing life insurance: (1) mutual, (2) stock, and (3) mixed companies. Since the contingency insured against under the life policy is certain to occur, only the time of its occurrence being uncertain, unlike other forms of insurance all insureds will ultimately partici-

[2] *Ritter* v. *Mutual Life Insurance Company*, 169 U.S. 139 (1898).

pate in the accumulated fund. This being the case, and the annual payments required for a group being determinable within narrow limits, life insurance is admirably adapted to the mutual form.

A mutual company is owned by the policyholders, and control of the company in their hands. Actual management of the business is in the hands of a board of trustees or directors chosen by the policyholders. Policyholders in this type of company hold voting rights not unlike those of a stockholder in a corporation. In some states policyholders may vote by mail, in person, or by proxy. As a matter of practice, it is contended that policyholders express little interest in elections and that those interested in the management of the company easily accumulate sufficient proxies to retain control. This criticism applies equally to the scattered stockholders of large corporations and is recognized in both forms of organizations as deserving of correction, though the means has not readily been found. In the case of mutual life insurance companies, it is pointed out that in times past when a vital issue has presented itself a sufficiently representative vote has been forthcoming.

Under the mutual form of life insurance company, the officers or trustees elected by the policyholders have no proprietary interest in the assets of the company. Profits of the company accrue to the benefit of all the policyholders, and the officers and trustees receive an agreed remuneration for their services.

Stock life insurance companies are corporations organized for profit. The initial capital is provided by a group of individuals who become the company's stockholders. Under this form of organization, control of the company rests with the stockholders instead of with the policyholders, each share of stock carrying a vote. Since the shares are transferable, control may be concentrated in the hands of a small group, and it may change from time to time. It is the stockholders, therefore, who elect the directors and officers of the company who are charged with the actual responsibilities of management. Dividends are paid the stockholders when skillful investment management or underwriting experience shows a profit in excess of the amount calculated as necessary to pay claims as they mature.

A mixed company is a stock company in which policyholders participate in the gains of the company. The plans under which mixed companies operate vary. Sometimes control of elections rests in the hands of the stockholders, and in some companies both policy-

holders and stockholders have a voice in elections. In the matter of elections, such companies are more nearly like the stock company, but in their distribution of gains to policyholders they are essentially mutual.

Old-Line Companies. The terms "old-line" and "legal reserve," as applied to life insurance companies, are used to designate those life insurance companies required by the state laws to maintain a reserve against all outstanding policies, mathematically determined in accordance with a statutory standard.

The term "old-line," as applied to legal reserve companies, is used to differentiate those companies as a class from fraternal, co-operative, or other forms of assessment companies having premium rates or assessments not definitely fixed. The old-line companies are required to file an annual sworn statement of the financial condition. It is because of the legal necessity of maintaining the reserve set up by the state as a minimum, plus the careful supervision by the state to see that the company meets its requirements in this respect, that the legal reserve company secures the confidence of the public.

The Beneficiary. The "beneficiary" under a life insurance policy is the person designated in the contract as the one to whom the proceeds are to be paid. An insured may take out a policy made payable to his executors, administrators, or assigns. When so written, in the absence of previous assignment, the insurance becomes an asset of the estate upon the death of the insured and is collectible by executors or administrators. In such a contract the insured is the beneficiary. When the policy designates a person other than the insured as beneficiary, he must be within a class permitted by law. If no beneficiary is designated, or is insufficiently designated, the insurance reverts to the estate of the insured.

The Premium. The consideration for which the insurance company undertakes to pay the amount of insurance in accordance with the policy terms is the "premium." To arrive at the exact premium charge for the various types of life insurance policies involves intricate mathematical calculation. There are, however, two major factors that influence the computation of all premiums. It is first necessary to accumulate sufficient funds to pay claims as they mature. Then, since certain expenses in life insurance, as in other forms of insurance, are incurred and must be met out of premium income, provision must be made for this item when the premium is computed.

That part of the premium which is designed to go into a fund to be used for the payment of policies as they mature is called the "net premium." The sum added to the net premium to cover the cost of doing business and to provide a sum to absorb shrinkages due to any unforeseen contingency is termed "the loading." The net premium plus the loading is the "gross premium." The gross premium is the amount paid by the insured for his policy.

The Mortality Table. The net premium or, as it is sometimes called, the "pure premium," is dependent upon the age of the applicant for insurance. The amount to be charged is derived from accumulated data assembled into a workable table called a "table of mortality."

Life insurance actuaries have been able to make up tables showing the mortality experience of large groups of people. The tables are arranged so that they show readily anticipated mortality for every age. Applying the principles of the theory of probability and the law of large numbers, life insurance underwriters have found that they can readily anticipate the number of deaths and the time of their occurrence in any large group. It is known that the accuracy of predictions is greater, the greater the number of cases under observation. This being the case, in calculating the ratio of deaths, the group, to be reliable, must be sufficiently large to come within the operation of the law of large numbers and permit variations from the average to cancel each other. Insurance actuaries have learned that it is not absolutely necessary to have all the cases in a group started at a given time. If the group cannot be made up of a sufficiently large number of cases at one time, it is found that much the same results are obtained if a small number of lives are insured, and the size of the group is built up by accumulating like cases over a long period of time. In other words, whereas a small group of insureds might throw the expectation out of line, in the long run these variations tend to cancel one another, and the experience and expectation coincide.

The number of deaths to be expected in a large group of a given age can be predicted with such a degree of certainty as to provide a basis for a safe calculation of life insurance premiums. The uncertainty in the case of the individual is reduced to a certainty as the individual is absorbed by the group.

A mortality table used by many large American insurance companies is known as the "American Experience Table of Mortality."

Associated with this table is the name of Sheppard Homans, Actuary of the Mutual Life Insurance Company of New York, who compiled the data and completed the table around 1860–61. The table was published in 1867 by the New York Insurance Department and has supplied the statistical basis for life underwriting since that time. The American Experience Table underestimates the death rate on the basis of present-day experience and, therefore, forms an extremely conservative basis for premium computation. At the suggestion of the National Convention of Insurance Commissioners, an investigation was completed by the Actuarial Society of America and the American Institute of Actuaries, and the findings were published in 1918. The data confirmed the experience of the individual companies with reference to the American Experience Table, and in an effort to secure a table that more accurately represented present-day conditions the "American Men Mortality Table" was computed. More recently a new mortality table prepared by a special committee working with the insurance commissioners and presented to the National Association of Insurance Commissioners in September, 1941, is known as "The Commissioners' 1941 Standard Ordinary Mortality Table." This table is based on the statistics of life insurance company mortality experience during the ten years 1931–40, inclusive. The table has the endorsement of the National Association of Insurance Commissioners and legislation has been adopted by a number of states authorizing its use. A new mortality table for industrial insurance, based on company experience in that division of the business, has also been constructed, and is known as the "1941 Standard Industrial Mortality Table."

Because of the improvement in public health since the American Experience Table was constructed in 1868, it has been sometimes stated that the table is responsible for an overcharge to policyholders. As a matter of fact, this is not the case, and it is not anticipated that the adoption of a modern mortality table will reflect greatly in the aggregate cost of insurance. This is true because premium rates based upon the American Experience Table do not measure the net cost of insurance to participating policyholders. When dividends are taken into consideration, the actual mortality experience is reflected in the cost of insurance to the insured. The new table is, however, a step in the right direction in that it will lead to more equitable distribution of insurance costs among the various types of insurance and classes of

AMERICAN EXPERIENCE TABLE OF MORTALITY

Age	Number Living	Dths. Each Year	Death-Rate per 1,000	Expect. of Life	Age	Number Living	Dths. Each Year	Death-Rate per 1,000	Expect. of Life	Age	Number Living	Dths. Each Year	Death-Rate per 1,000	Expect. of Life
10.....	100,000	749	7.49	48.72	39.....	78,862	756	9.59	28.90	68.....	43,133	2.243	52.00	9.47
11.....	99,251	746	7.52	48.08	40.....	78,106	765	9.79	28.18	69.....	40,890	2.321	56.76	8.97
12.....	98,505	743	7.54	47.45	41.....	77,341	774	10.01	27.45	70.....	38,569	2.391	61.99	8.00
13.....	97,762	740	7.57	46.80	42.....	76,567	785	10.25	26.72	71.....	36,178	2.448	67.66	8.00
14.....	97,022	737	7.60	46.16	43.....	75,782	797	10.52	26.00	72.....	33,730	2.487	73.73	7.55
15.....	96,285	735	7.63	45.50	44.....	74,985	812	10.83	25.27	73.....	31,243	2.505	80.18	7.11
16.....	95,550	732	7.66	44.85	45.....	74,173	828	11.16	24.54	74.....	28,738	2.501	87.03	6.68
17.....	94,818	729	7.69	44.19	46.....	73,345	848	11.56	23.81	75.....	26,237	2.476	94.37	6.27
18.....	94,089	727	7.73	43.53	47.....	72,497	870	12.00	23.08	76.....	23,761	2.431	102.31	5.88
19.....	93,362	725	7.76	42.87	48.....	71,627	896	12.51	22.36	77.....	21,330	2.369	111.06	5.49
20.....	92,637	723	7.80	42.20	49.....	70,731	927	13.11	21.63	78.....	18,961	2.291	120.83	5.11
21.....	91,914	722	7.85	41.53	50.....	69,804	962	13.78	20.91	79.....	16,670	2.196	131.73	4.74
22.....	91,192	721	7.91	40.85	51.....	68,842	1.001	14.54	20.20	80.....	14,474	2.091	144.47	4.39
23.....	90,471	720	7.96	40.17	52.....	67,841	1.044	15.39	19.49	81.....	12,383	1.964	158.60	4.05
24.....	89,751	719	8.01	39.49	53.....	66,797	1.091	16.33	18.79	82.....	10,419	1.816	174.30	3.71
25.....	89,032	718	8.06	38.81	54.....	65,706	1.143	17.40	18.09	83.....	8,603	1.648	191.56	3.39
26.....	88,314	718	8.13	38.12	55.....	64,563	1.199	18.57	17.40	84.....	6,955	1.470	211.36	3.08
27.....	87,596	718	8.20	37.43	56.....	63,364	1.260	19.88	16.72	85.....	5,485	1.292	235.55	2.77
28.....	86,878	718	8.26	36.73	57.....	62,104	1.325	21.33	16.05	86.....	4,193	1.114	265.68	2.47
29.....	86,160	719	8.34	36.03	58.....	60,779	1.394	22.94	15.39	87.....	3,079	933	303.02	2.18
30.....	85,441	720	8.43	35.33	59.....	59,385	1.468	24.72	14.74	88.....	2,146	744	346.69	1.91
31.....	84,721	721	8.51	34.63	60.....	57,917	1.546	26.69	14.10	89.....	1,402	555	395.86	1.66
32.....	84,000	723	8.61	33.93	61.....	56,371	1.628	28.88	13.47	90.....	847	385	454.54	1,42
33.....	83,277	726	8.72	33.21	62.....	54,743	1.713	31.29	12.86	91.....	462	246	532.47	1.19
34.....	82,551	729	8.83	32.50	63.....	53,030	1.800	33.94	12.26	92.....	216	137	634.26	0.98
35.....	81,822	732	8.95	31.78	64.....	51,230	1.889	36.87	11.67	93.....	79	58	734.18	0.80
36.....	81,090	737	9.09	31.07	65.....	49,341	1.980	40.13	11.10	94.....	21	18	857.14	0.64
37.....	80,353	742	9.23	30.35	66.....	47,361	2.070	43.71	10.54	95.....	3	3	1000.00	0.50
38.....	79,611	749	9.41	29.62	67.....	45,291	2.158	47.65	10.00					

policyholders. Although a number of states have authorized use of the new table, the American Experience Table is still widely used both as the basis for computing premiums and for nonforfeiture values.

The American Experience Table of Mortality traces the mortality history of 100,000 persons from the age of ten until there are no survivors. For example, reference to the table will show that at the end of the first year, of the 100,000 persons there will have been 749 deaths and 99,251 survivors. Reference to any age following will give the number of survivors of the original group, or a comparison of one age with another will give the number of deaths to be anticipated in the surviving group. For example, at the age of fifty the table shows that 69,804 of the original 100,000 will be living. It further shows that of the 69,804 survivors, 962 may be expected to die before reaching the age of fifty-one. Insurance statisticians are careful to explain that the figure indicated for "expectation of life" is an average and to have value must be applied to a sufficiently large group. For the individual, who obviously may live many years beyond the expectation figure indicated or, on the other hand, meet with sudden death, the table has no significance whatever.

The Life Insurance Equation. There is no mystery about the life insurance business. The principle upon which it is based is simple. The members of a group large enough to come within the operation of the law of large numbers make payments into a common fund which must be large enough to pay the benefits agreed upon.

Life insurance, considered in the light of the individual contract, has been to many an incomprehensible transaction. Knowing that nothing is as certain as death and likewise that nothing is as uncertain as when it will occur, the company that is willing to agree to pay, in consideration of the payment of a comparatively small premium, thousands of dollars or even millions, whether death occurs immediately after the insurance becomes effective, within a week, a month, a year, or many years, seems to be assuming a risk beyond the understanding of all but a few initiated to the mysteries of actuarial science.

The key is to be found in the fact that life insurance deals not with individuals but with groups. No life insurance underwriter can possibly have the vaguest intimation of the length of life of the most promising candidate. An insured may meet with an accident and be killed five minutes after insurance becomes effective. Such happen-

ings come within the calculations of the life underwriter as long as the transaction is in no way tainted with fraud. Because for every insured in the group who will meet early death there will be other insureds who will live far beyond the life expectation, the deaths each year will fall in easily predictable averages.

In its simplest form, there is here given the method of computing a life insurance premium, assuming 10,000 individuals aged forty-seven wished to insure their lives for a period of one year for $1,000. Reference to the American Experience Table of Mortality indicates that the death rate per 1,000 is 12. The life insurance company, therefore, will count on 120 deaths during the year, or payments equal to $120,000. Since there are 10,000 in the group to pay the losses at the beginning, if a premium of $12 is collected from each of these and the death experience is exactly that of the expectation, the insurance company will have $120,000 with which to pay claims and the account will balance to a cent. In the interests of simplicity, the costs of doing business are at this point not considered.

Since, however, there is no assurance that the death rate will exactly follow the expectation in the given year, insurance companies collect somewhat more than they need to pay the expected claims. In addition to this, they add to the premium enough to pay the operating expenses of the company. Finally, they expect to make a profit by investing the funds in their hands, and this profit is used to reduce the cost of insurance. If, at the end of the year, the company is able to operate at an expense less than it calculated, if the excess collected to provide for emergencies in death claims is not needed, or if the death claims do not equal the tabular expectations, the savings are accumulated and apportioned back to the premium payer as a dividend. Thus, the fund balances.

When the insurance is for the whole life of the insured, the insurance company undertakes to pay a definite sum whenever death may occur. Because of this, the type of insurance is known as "whole life insurance." The principle upon which it is based is essentially the same as that already described. For example, a large group agrees to pay into a common fund, and out of this fund $1,000 is paid to the beneficiary of each member of the group upon the occasion of his death. At the start, all are of the same age and, as nearly as it is possible to determine, are in sound health. Which members of the group will die within a comparatively short time and which

will live to very old age, no one knows at the outset. The insurance underwriter does, however, have a very close approximation of how many in the group will die each year until there are no survivors. Knowing this, he knows how many will be paying premiums each year. Computing the annual premium payments and increasing them by the amount of interest he knows he can earn, he is able to compute how much must be paid to have on hand funds to pay the death benefits to each member of the group when death occurs.

The limited payment policy is a whole life form but is distinguished from the ordinary life policy, which provides for premium payments for as long as the insured shall live, in that premium payments are made only for a definite number of years. The more usual premium payment periods are ten, twenty, or thirty years. So far as premiums are concerned, the contract differs from the ordinary life policy only to the extent that those who survive the premium payment period indicated in the policy are relieved from cash payments for the remainder of their lives. The policy does not mature until death. It is necessary, therefore, that the insurance company accumulate money enough during the premium payment period to pay, when this fund is augmented by interest, the face of all the policies as they mature. As before, all the members of the group start on even terms. Some will die young, some will live to old age. On the basis of mortality experience, the insurance company knows, within workable limits, how many premiums it can expect during the premium payment period, and how many policies will mature each year from the inception of the contracts until there are no longer any survivors. Computations are so made that the funds will exactly pay the benefits, and when all benefits are paid nothing will be left.

The endowment differs from the whole-life policy in that the face of the policy is paid if the insured is living at the end of the term indicated in the contract. If the insured dies during this term, the face of the policy is paid, as in the case of the whole-life policy, to the designated beneficiary. Thus, with a twenty-year endowment contract for $1,000, if the insured lives to the end of the term he will receive $1,000, but if he dies before the end of the term, $1,000 will be paid to whomever he designates as beneficiary. The insurance company knows, on the basis of its mortality calculations, how many will live to the end of the period. It knows how many survivors will live to pay premiums each year and how many claims will have to be paid

during the endowment period. It collects premiums enough to pay all these benefits. Naturally, accumulations must be made as the years go by to pay those policies that mature as endowments. The company cannot pay the face of the policy and the accumulations too, because the premiums are predicated upon having funds enough to pay the face of the policy only. A policy could be devised that would pay the full face amount plus an accumulated savings. However, no advantage would accrue from such a policy because it would simply mean that the premiums would have to be higher.

As before, all members of the group start equal. That some may receive the face of their policies with but a few dollars paid in, while others must pay during the entire endowment period, is simply a fortuitous circumstance with which all are familiar at the outset of the agreement.

A term policy, an ordinary life policy, a limited payment policy, and an endowment policy, for $1,000 each, pay the face of the policy, or $1,000, when the insured dies. Each policy carries a different premium charge. The term policy is the lowest, and there are increasingly higher rates for other forms until the endowment is reached, which calls for the highest premium. This is not a different charge for the same thing; the insured, when he buys his policy, decides of which group he wishes to become a member. The group he selects depends upon his needs and circumstances. In every case the premium is computed upon the basis of the coverage afforded in the contract. The insurance company receives no more benefit or profit from the high-priced policy than it does from the low-priced policy. The premium receipts, in every instance, are divided among the members of the group in accordance with the plan determined upon when the group is made up, that is, when the policy is issued.

Premiums Advance as Age Increases. The problem of computing the cost of insuring a group at any age for a period of a year is a matter of simple arithmetic. For example, reference to the mortality table shows that of the 69,804 persons at the age of fifty, there will be but 68,842 survivors at the age of fifty-one. In other words, there will be 962 deaths during the year. To insure the group of 69,804 persons for $1,000, therefore, disregarding for the time being the cost of doing business, will cost 962 $\times$ $1,000, or $962,000. Since this cost is to be divided among 69,804 persons, the premium each is required to pay is $13.78.

If the group wishes to continue the insurance for another year, the process is repeated, except that the data from the table for the new age are used. As age increases, the deaths per thousand increase. This being the case, any program of life insurance for a group of a given age, in order to remain solvent, involves a continued increase in the pure premium charge at each age for the surviving members of the group.

While the pure premium charge is comparatively small when the insured is young, this charge increases sharply during the latter part of the life of the surviving members of a group.

The Net Natural Premium. The net natural premium represents the amount that each insured must pay into the insurance fund at the beginning of a year so that the beneficiary of each insured who dies during that year may receive the amount of the insurance. This premium has sometimes been defined as "the cost to each individual of the death claims of the group."

Aside from the data supplied in the mortality table, the computation of the net natural premium takes into consideration the element of interest. The life insurance premium is payable at the beginning of the policy term. Deaths will occur at any time, and the insurance is payable immediately. Nevertheless, a substantial part of the fund will be available for investment. The actual cost of the share of the death losses to each insured must allow a credit for interest earnings on the premium.

As a matter of actual practice, life insurance companies follow a standard formula in working out premium rates. They assume the payment of all premiums at the beginning of the policy term and the payment of all losses at the end of the term. This being the case, the interest rate used in the calculations must be one which the company can safely assume to earn on the entire premium over the full policy term. Interest rates used for this calculation have been as high as 4 and 4½ per cent. More recently 3 and 2¾ per cent have been used, and the present tendency is toward a lower rate.

The net natural premium, therefore, is computed by applying an interest credit to the natural premium computed from the mortality table. Thus, as already noted, the natural premium at the age of fifty is $13.78. Applying a credit for an interest earning on the basis of 3 per cent, the net natural premium becomes $13.38. Using 3½ per cent as the interest rate, the net natural premium becomes $13.31.

By adding the loading factor to the net natural premium, one obtains the gross natural premium. This represents the premium charged the insured for his policy. Since the pure premium is the basis for computing the natural premium, companies using the natural premium as a basis for their premium charge must collect a constantly increasing amount as the ages of the insureds increase.

Natural Premium Plan Unpopular. As a matter of actuarial computation, it can be demonstrated without question that the natural premium plan is both sound in theory and equitable in operation. In spite of this fact, this method of collecting life insurance premiums has met with such scant success that it has been abandoned by all but some of the so-called "assessment organizations."

The cause of the failure of this plan in actual practice is to be found in the unfavorable reaction of insureds to a constantly increasing premium cost. Regardless of the fact that the insurance premiums might have been considered extremely low in the beginning, as time passed, the burden of a constantly increasing premium charge tended to become more and more irksome. The result was inevitable. Large numbers of policies were allowed to lapse. Those members whose health was impaired tended to cling to their insurance, with the result that death claims began to be unfavorably out of line with expectations.

A solution of the difficulty was found in the computation of a rating plan that permitted a premium charge for the various ages of applicants that would remain fixed throughout the life of the insured. If the premium charged is the same from year to year, it is termed a "level premium."

The Net Level Premium. The net level premium is found by means of proportion and, like the natural premium, is based upon the data of the mortality table. After determining the natural premiums for any given term, then by discounting the interest item they are reduced to a present value, the sum of the premiums reduced to a present value will represent a lump sum that will pay for the insurance for the entire term. This sum is called the "net single premium."

By utilizing the mortality table and discounting future payments, the company computes a net single premium for any term, or for life at any age. The net annual level premium bears the same relationship to the net single premium, as one dollar annual level premium

bears to the present value of the one dollar premiums for the term. To change a net single premium to a net level premium, it is necessary first to find the value of the annuity due of $1.00 a year for the term. This value is the net single premium for the annuity. By dividing the net single premium for the insurance by the net single premium for the annuity, the resulting answer is the net level premium for the policy term.

Knowing the natural premium, one may find the net single premium. Knowing the relationship between the net single premium and the net level premium, one may then determine the net level premium itself. By adding the loading factor, the level premium to be charged the insured is found.

The important point to be recognized in this connection is that the level premium is as truly derived from the mortality table as is the natural premium. The level premium involves a charge in the earlier years in excess of the natural premium. This excess is termed "the reserve" and is invested to make up the deficiency caused by the level premium in the more advanced years being less than the natural premium.

The Reserve. When a premium for insurance is paid upon a natural basis the charge is computed to meet the death claims from year to year, plus the cost of carrying on the business. As has already been pointed out, the natural premium increases from year to year.

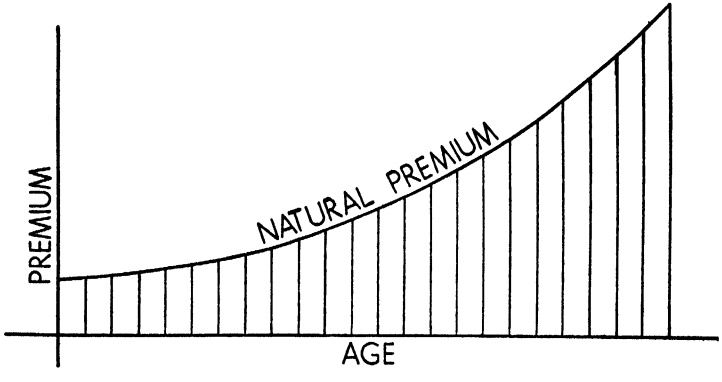


FIG. 3.—Natural premium trend

Figure 3 illustrates the trend of a natural premium. The vertical lines represent the premium charge of each succeeding year. Figure 4 indicates the level premium payments for the same age.

Superimposing one curve upon the other but eliminating for simplicity the vertical lines representing annual premiums, one sees at once the extent to which excess payments are made during the earlier years (Fig. 5). The deficiency during the later years is likewise shown. The area *A, B, C* represents the excess premiums paid during the

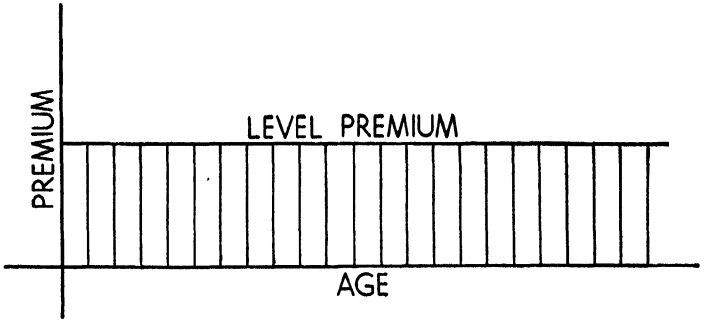


FIG. 4.—Level premium trend

earlier years. The area *C, D, E* represents the excess of the current natural premium during the later years over the amount actually collected from the current level premium. The sum accumulated from the payments represented by *A, B, C,* plus the interest derived from their investment, represents the reserve accumulated to carry the

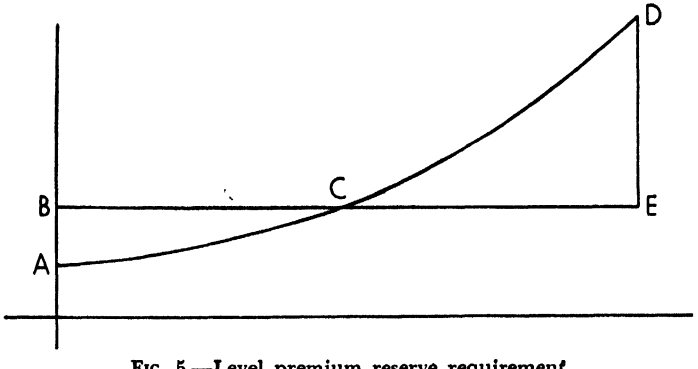


FIG. 5.—Level premium reserve requirement

policy until paid. It is to be pointed out that life insurance is a group undertaking. In computing the adequacy of a reserve, therefore, the company considers all the policyholders of a group. If an individual carries a policy a few years and dies, he pays more than the natural premium for his insurance, but this excess is not a profit to the company since his payment to the reserve is necessary for the solvency of the group.

The reserve is always available to the policyholder. If he wishes to withdraw from the group after a given number of years, he may secure his reserve, less a small expense charge. The fund so paid is termed a "cash surrender value," and most policies indicate what this will be from year to year. Again, if the insured prefers, he may borrow against his reserve, paying interest for the sum so borrowed. In this case, he does not cancel his insurance. The amount that may be borrowed on a policy increases as the reserve increases and is referred to as the "loan value."

With reference to each single policy, the reserve grows as the years pass. The difference between the reserve and the face of the policy at any given time represents an amount termed by insurance companies the "amount at risk." As time runs, therefore, the amount at risk decreases until it ultimately vanishes, unless death intervenes to mature a claim.

The statement, frequently made, that the reserve accumulated against a life insurance policy should be paid to the beneficiary along with the face of the policy, is either the outgrowth of a misunderstanding of a basically simple principle of insurance, or is a malicious misstatement deliberately designed to confuse. As a matter of fact, the reserve is not assigned to each particular policy. Each particular policy has an equity in the total reserve, and if the insurance is canceled this equity may be withdrawn. That is, a $1,000 policy having a $600 cash surrender value may be turned in to the company for $600. This terminates the insurance. If the policyholder wishes to be protected, however, he must leave his reserve in the common fund and take his chances with all the members of the group. If he remains with the company as an insured and dies very soon, he gets the face of his policy. If, on the other hand, he remains until the reserve has accumulated to a point where his contributions plus interest accumulations virtually equal the amount he paid in, he has in no way suffered a loss but has been particularly fortunate in enjoying a long life. This point was clarified in the discussion of the insurance equation.

Medical Examination. Before issuing a life insurance policy, the insuring company will ordinarily require a medical examination made by a physician appointed by the company for the purpose. Exception to this rule may be made when group policies are issued, though even in such cases an examination may be required of in-

dividuals who delay in joining a group. There are certain other exceptions such as industrial policies sold ordinarily for small amounts and payable on a weekly payment plan. In other instances, policies are written making use of the so-called "nonmedical plan," which contemplates placing an increased burden on sources other than the medical examiner for required underwriting information. For the great volume of insurance business, however, it is largely upon the findings of the medical examiner, incorporated in a report to the company, that the applicant is determined to be an acceptable candidate for insurance or a reject.

In life insurance computations, it is assumed that the effects of medical selection disappear after a period of five years. A mortality table based upon the subsequent history of lives that have been insured for a period of five or more years is termed an "ultimate table." Since the American Experience Table of Mortality is such a table, it is sometimes contended that it affords the mortality rate without regard to medical selection and, therefore, that insurance companies could safely write life insurance without a medical examination.

To refute this contention, actuaries point out that if everyone in a community or country were insured, a medical examination would be unnecessary. A sufficient number of insureds would be included in the group, and the mortality table would reflect the mortality rate with accuracy. Since, however, insurance is purely a matter of volition on the part of the individual, without medical examination there would be a tendency for the unhealthy to seek insurance, while others might neglect or postpone it. The result would be a group of risks unfavorably balanced with defectives and a mortality rate in excess of that anticipated by the table. Where such a situation exists, there is said to be a condition of "adverse selection."

The Loading. The amount added to the net premium for expenses and contingencies is not uniform with all companies. In mutual companies the loading is frequently heavier than is the case in stock companies. In the case of the mutual companies the additional premium strengthens the position of the company, and at the same time any inequity is avoided through a return of any excess in the form of dividends to the policyholders.

The element of loading provides, first, for the expenses attendant upon carrying on the business and, second, for possible contingencies unforeseen in the calculations. The expense element includes such

items as the cost of getting business and the cost of collecting premiums. Principally to be considered in these items are commissions on new business, subsequent commission payments for a term, and the tax levied on premiums. Other expense items include the cost of settling claims and, finally, such general expenses of the business as salaries, wages, rentals, and the like.

Contingencies contemplated in the loading include failure of the company to earn the assumed interest, mortality in excess of that used for calculating the premium, security depreciation, investment losses, and the like. It is the intent that this part of the loading absorb any shrinkage due to failure of actual experience to meet the expectation of the calculations.[8]

Savings. It has been noted that three factors are considered in computing the rate to be charged for a life policy; namely, (1) mortality cost, (2) the interest rate assumed to be earned, and (3) the loading. When the experience with reference to any of these items is more favorable than anticipated in the computations, a saving or profit accrues.

In the case of mutual companies there is no profit in the insurance transaction for the company itself. Whatever is accumulated in excess of needs is reapportioned to the policyholders in the form of a dividend. There are no stockholders or other interests in the company than the policyholders themselves. All officers and employees of the company are compensated by salary. Especially favorable operations increase the benefits to the policyholders. By the same token, a period of unfavorable operations tends to increase the net costs to the policyholders in the form of a reduced dividend.

Life insurance companies that operate on the stock principle are organized as corporations, and ownership is represented by shares of stock. These companies do not include in the premium as much of a factor of safety as mutual companies charge; instead, the cushion against unforeseen contingencies is to be found in the capital stock paid in by the stockholders. Although a dividend in the form of earnings is allocated to the holders of stock, companies organized on

[8] Numerous theories have been advanced as to the procedure to be followed in computing the item of loading. Some of the expense items vary with the amount of the premium. General expense items do not so vary. To add a percentage of the premium for loading to compensate for one class of items, such as commission charges and collection costs, and a flat sum to cover general expense items that do not vary with the premium has seemed an equitable solution.

this basis are forced through competition to keep their rates closely in line with the net costs of insurance as provided by mutual companies. To do otherwise would have the effect of driving business from their doors. While stock and mutual companies in the life insurance field each have sound claims to put forth regarding the virtues and advantages of their respective methods of doing business, the mutual idea has so thoroughly dominated the life insurance business that it has the effect, in the long run, of bringing all net costs very close one to the other.

The American Experience Table of Mortality, as has been noted, is an ultimate table; that is, it gives no consideration to medical selection. Since insurance companies make a selection on the basis of a medical examination, the mortality experience indicated in the table, particularly in the earlier years, is considerably in excess of that shown when medical selection is followed. Again, the general mortality rate has decreased since the table was computed. Because of these features, the actual mortality experience tends to be less than the computations would indicate. This is a source of dividends to the policyholder.

Companies are most conservative in the interest rate they assume for their calculations. If any error is to be made, obviously it should be made on the side of caution. The investment department of every company strives to earn the maximum amount consistent with safe practices. Accordingly, the company will realize an additional saving whenever the investment department succeeds in earning more on its invested funds than the interest rate assumed for the purpose of calculating premium rates.

Within recent years the downward trend in interest rates has tended to reduce the amount of savings from interest available for dividends. Some years ago companies were averaging as high as 5 per cent on their earnings, but more recently the average is nearer 3½ per cent.[4] To some extent there has been a compensating factor in the net available for dividends in that, while earnings from interest

[4] The net earnings of forty-nine life insurance companies, representing 92 per cent of the total admitted assets of all United States Legal Reserve Life Insurance companies, was, for the year 1930, 5.03 per cent. At the end of 1940 the average rate was down to 3.44 per cent. Had there been no reduction in interest from 1930 to 1940, it is estimated that the actual earnings from interest would have been increased by $2,400,000,000. It is further estimated that these same companies would have earned $425,000,000 more in the year 1940 alone had the earnings for 1930 of 5.03 per cent prevailed.

have been declining, savings from favorable mortality experience have been increasing. The counteracting effect of the operation of these two factors has tended to lessen the extent of dividend reductions that declining interest rates alone might otherwise have made absolutely necessary. It is nevertheless to be emphasized that declining interest rates have definitely made themselves felt both in the calculation of insurance premiums for policies now being issued and in the computation of dividend rates for policies already outstanding.

Finally, the management of the company, if carried on in an efficient and careful manner, not only will keep management expenses at a minimum but may likewise succeed in avoiding an income shrinkage from contingencies such as investment losses or adverse mortality experience due to the lapsing of healthy policyholders. When efficient management is able to keep expenses and contingent losses under the amount contemplated by the loading, a third source of profit is found.

The sum of the savings from all sources is accumulated in a fund called the "surplus." The ultimate disposition of the surplus depends upon the type of business organization the insurance company happens to be and whether the policies it issues are participating or nonparticipating.

The Surplus. A part of the surplus derived from the savings may be allowed to accumulate in a fund to give strength and stability to the company. Such of the savings as are not set aside for accumulation are distributed.

In a mutual company, the surplus belongs entirely to the policyholders. In the absence of a capital subscribed by stockholders, as an element of protection, it has already been noticed that mutual companies collect, through heavy loading, a premium actually in excess of needs. The excess ultimately becomes a part of the surplus and is returned to the policyholder in the form of a premium refund. Savings from any other source likewise become a part of the refund, which is termed a "dividend."

If the company is a stock organization writing participating policies, an agreed percentage of the surplus is set aside for distribution to the policyholders, and the balance is added to the reserve fund, from which dividends for the stockholders are declared from time to time. If the company is a stock company but writes only nonpartici-

pating policies, the entire savings is available for dividends on the stock. It is pertinent, however, to mention at this point that most life policies now issued, whether by stock or by mutual companies, participate to some degree in the savings. Where nonparticipating policies are issued, relying upon the safety factor afforded by the subscribed capital and accumulated surplus, the excess loading as an additional element of safety is eliminated, and a lower initial premium charge is made than is the case where the mutual company has no capital stock and the policies issued are participating.

Substandard Risks. The purpose of the medical examination is not to find a perfect group for insurance. It undertakes, however, to eliminate from the group those suffering from ailments that tend to increase the mortality beyond that which the mortality table anticipates. Second, it has as a function the detection of such fraud as that of an applicant who, aware of a very serious ailment, makes application for insurance. In an effort on the part of insurance companies, however, to secure the best mortality experience possible, the rejections until recently left a very large group in a category listed as "uninsurable." One of the recent outstanding developments in the field of life insurance has been the completion of data making possible insurance for impaired risks.

An impaired or substandard risk is listed as one in whom the hazard may be presumed to be increased because of the existence of unfavorable physical condition, family history, habits, or occupation. Writing of this class of business is of recent development. In 1896 there were but three companies accepting such lines. Two of them were organized to accept business declined by other companies, and the third accepted substandard lines in connection with its other business. Because of the very nature of life insurance, the business of writing substandard risks was viewed with concern, and companies accepting such lines were frequently criticized by their competitors.

Among the earlier attempts at writing this class of business was that undertaken by one company in 1895. This company issued deferred-dividend policies in special occupational classes. The dividend was not distributed until the end of twenty years and was contingent upon the mortality of the class. This company wrote a large amount of business and, as a result of the statistical data obtained, secured material for promulgating substandard rates. Other studies in the field were made, and in 1929 a report of a joint committee on

mortality, composed of actuaries and medical directors, presented the results of investigations into 627 occupations, involving investigations of 1,300,000 cases. Another outstanding piece of work in all the investigations into impaired lives is known as the "Medico-Actuarial Mortality Investigation," started in 1909 and completed in 1914. The work was carried on by a committee of the Actuarial Society of America and the Medical Directors' Association. The report was published in five volumes, and the data were drawn from 2,600,000 cases placed at the disposal of the committee.

Subsequent studies followed, some giving particular attention to physical impairment, others to occupations and habitat. With the development of scientific data upon which to base calculations, the business of writing insurance on substandard lives advanced rapidly.

Substandard risks fall into two groups. In the first group, the insured is charged an extra premium or, what amounts to the same thing, is charged at an advanced age, to compensate for the hazards of his occupation. These additional charges for occupational hazards are in some instances moderate and in others, as compared with the usual premium for the age, very severe. The mortality range for occupational hazards varies from an additional charge of one-third to three times normal mortality.

The second group of substandard risks includes those with physical impairments. The most important of these include heart murmur, overweight, albumin in urine, family history of tuberculosis, pulse irregularity, and high blood pressure. The impairments indicated are among those of most frequent occurrence. There is a wide range of others for which data have been accumulated. The investigations of the insurance companies now enable them to determine an equitable additional premium to charge for such risks.

The extent to which life insurance companies have gone in making insurance available for everybody may be indicated by the fact that out of 1,100 occupations only 9 are regarded as uninsurable and 450 are accepted without additional premium. In the classification of physical impairments, those generally held not to be insurable are cancer, gastric ulcers, insanity, epilepsy, Bright's disease, serious heart trouble, very rapid pulse, and a recent history of tuberculosis.[5]

[5] For the purpose of working out the additional charge for a substandard risk, insurance companies have a practice of weighing separately each factor that may have a bearing. The mortality of an average person is regarded as 100 per cent. Credits and

Nonmedical Life Insurance. It has already been pointed out that the major purpose of a medical examination as a part of the process of life underwriting, is the prevention of adverse selection. This being the case, it has been contended that much of the information required to prevent adverse selection may be obtained without necessity of a medical examination. To this end, with a view to reducing acquisition expense, and eliminating the delay sometimes caused in securing an examination, and finally to overcoming the danger of sales resistance that sometimes presents itself in the form of an objection to a medical examination, the plan of writing life insurance without such an examination was instituted.

In Canada, where it made its first appearance, a substantial number of life insurance applications was received in rural districts where the services of a physician were not always readily obtainable. This is said to have been one of the major factors leading the Canadian companies to adopt the idea. This same factor—the lack of doctors available for medical examinations—was an important contributing factor to the further extension of nonmedical life insurance business during the period of the second World War. There has, as well, been a decided trend in recent years to extend the geographical areas in which nonmedical insurance is written. The form is not limited to rural communities, and most companies are writing it in all communities except large cities.

It is not the intention of companies writing insurance on the nonmedical plan in any sense to let down the bars of their standard classification. Rather, the nonmedical plan contemplates placing an increasing burden upon the other sources of information. This increase rests most heavily upon the agent, and for this reason the privilege of submitting nonmedical applications is not granted to agents indiscriminately.

The nonmedical application places upon the agent the duty of securing much of the information heretofore obtained by the medical

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debits are applied to this base, and the result is the expected mortality of a group of individuals so impaired. A favorable family history will give a credit, whereas an unfavorable history will result in a debit. Debits are given for those who are overweight. Credits are allowed when the occupational risk is especially favorable. Classifications such as minister, teacher, and farmer get credits; debits are assigned to those engaged in hazardous industrial occupations. Certain debits are assigned in the case of disease history or physical impairment. The credits are deducted from the assumed mortality of the average, and the debits added. The algebraic sums represent the expected mortality.

examiner. The agent, of course, does not undertake anything in the nature of an actual physical examination. He does, however, secure directly from the applicant much of the necessary information touching upon personal and family history and physical condition. This is obtained by securing from the applicant specific replies to carefully drafted questions.

The agent is asked also to assure himself, so far as it is possible for him to do so, that the applicant is in sound health, able to attend his work regularly, and not suffering from any impairment or ailment that requires cessation or interruption of employment.

Applicants for nonmedical life insurance are ordinarily limited as to age. A customary age limit is fixed at forty-five years. It is felt that applicants in the younger brackets will not have developed such impairments as lung, heart, or kidney troubles that can only be discovered, if at all, by careful examination of a physician. It is true that younger persons are not entirely free from such impairments, but it is contended that they are sufficiently free to allow the law of averages to work out in such a way that unusually sound risks will compensate for the occasional impairment that may slip by. In some instances, companies will not place as high an amount on women as upon men, and there are some companies who will not accept women at all. Other companies make a differentiation between married and unmarried women. As to amount, some companies have placed a limit of $2,500 on a single application, but others will accept an application for an amount as high as $5,000.

In the case of nonmedical applicants, the information obtained by the agent is carefully verified through the agency of an independent inspection report. These reports are made by investigators trained in the field, and in addition to verifying the information obtained by the agent check upon such matters as intemperance or immoral habits. Infrequently the information obtained, as a result of this inspection, may be of a nature that indicates the possibility of an impairment, and in such circumstances a medical examination is required. On the other hand, those companies making extensive use of the plan indicate that the majority of such applications are disposed of without the necessity of an examination.

War Clauses. While primarily of academic interest since the termination of hostilities, it is nevertheless interesting to note, as a matter of insurance theory, the effect of the war upon life insurance

underwriting. It has already been noticed that life insurance premiums are predicated upon mortality experience. All mortality tables in use for the purpose cover the experience over a normal period and do not reflect death rates to be expected as the outgrowth of major military operations. Hence, to accept insurance on lives of persons in active military service without any limitation as to the liability for war-caused deaths might well affect the solvency of the company, or in any case affect adversely the position of other insureds as to dividends. Life insurance companies have recognized this situation and have invariably attached the so-called "war clause" to policies issued during wartime. Some companies did not make the use of the clause universal but limited it only to those of an age liable to military service. Some companies were willing to assume the war hazards on the payment of an additional premium but because of the size of the premium required very little of such business was written.

There have been in use two general types of clause: (*a*) the status clause, and (*b*) the result clause. The first of these excludes liability for all deaths occurring while in military service during wartime. The second excludes death resulting from war. There has been considerable objection expressed to the clause of the first type, since it is quite possible that death might occur from a normal cause that would in no way be associated with wartime service and would, except for the clause, be covered by the policy. This type of clause, however, is the simplest to interpret. The "result clause" is fairer in theory but extremely difficult to administer. This is so because of the difficulty of determining whether deaths from disease, exposure, or the like are directly attributable to wartime activities, or whether they might have happened in any case in the normal course. Because of its fairness, however, the second type of clause is the one most widely used.

The National Association of Insurance Commissioners' Committee on Life Insurance appointed a subcommittee on July 1, 1942, to study the matter of war clauses and make recommendations for a uniform practice. The recommendations the outgrowth of the conclusions of the study follow:

I. (*a*) No war restrictions or exclusions where the cause of death arises in the Home Area.

(*b*) Exclusions or restrictions (i) in the event of death occurring outside

the Home Area while in the military, naval or air forces of any country at war, or (ii) in the event of death occurring within the Home Area within six (6) months after returning thereto, as a result of causes arising while in such forces outside the Home Area.

(*c*) In the case of civilians traveling or working abroad, exclusions or restrictions in the event of death occurring within two (2) years from the date of issue of the policy as a result of war where the cause of death occurs while the insured is outside the Home Area and dies either outside such area or within six (6) months after returning thereto.

(*d*) No restrictions or exclusions in the event of death occuring as a result of travel or flight in any species of aircraft while a fare-paying passenger on a commercial line flyiing on a regular route between definitely established airports.

II. The term "Home Area" shall mean the forty-eight states of the United States, the District of Columbia, the Dominion of Canada and Newfoundland.

A number of states have adopted the recommendations. The majority of the large insurance companies have, in any case, voluntarily adjusted their practices to the recommendations of the commissioners.

FOR REVIEW

1. Explain the method of computation for a term policy for $1,000 for one year.
2. How does the computation of a whole-life premium differ from the computation of a term premium for a single year?
3. The Dash Life Insurance Company is a mutual organization, and the Blank Life Insurance Company is a stock company. Both use the American Experience Table of Mortality and compute their premiums on a 3 per cent basis. Which company would you expect to have the largest reserve on a whole-life policy in force for fifteen years?
4. X has a 10-payment life and a 20-payment life policy in the Dash Life Insurance Company. At the end of twenty years which will have the greater reserve?
5. B is a lawyer, but wishes to engage in the life insurance business on a part-time basis. A number of the full-time agents in B's state, in an effort to eliminate competition, have prevailed upon the insurance commissioner to refuse a license to part-time agents. The license is refused. Has B any recourse?
6. What are the sources of surplus to a life insurance company from which it may return a dividend to its policyholders?
7. It is sometimes said that the hazard of permanent and total disability is not properly assumed by life insurance companies. In the light of the theory upon which life insurance is based, what is your opinion?

8. Many life insurance companies engage in an extensive program of life conservation. What bearing can the success of such a practice have upon life insurance?
9. In rating substandard risks the following factors are considered: (*a*) build, (*b*) family record, (*c*) occupation, (*d*) personal history, (*e*) habits, (*f*) physical condition, (*g*) residence, (*h*) moral hazard. Investigation shows that the character of the applicant is questionable, and as a result the factor of moral hazard is given an unfavorable rate. All other factors are favorable. Is this an acceptable substandard risk?
10. C claims commissions are due him from B because of life insurance sold. B, the defendant, refuses to pay the commissions on the ground that C was not a duly authorized agent. B claims that the New York law violated both the federal and state constitutions in that it conferred on the superintendent, "absolute power to refuse a certificate for any reason, however arbitrary or unreasonable, or for no reason at all." The New York statute provided: "The Superintendent of insurance shall have the right to refuse to issue or renew any such certificate in his discretion." In your opinion, is such a law constitutional and enforceable?
11. Over a period of years there has been a persistent increase in the death rate from cancer. If the trend continues, it is expected that there will be more deaths from this cause than from tuberculosis. Heart disease has likewise been showing a consistent increase over a period of years. Can you give an opinion as to the effect of these increases upon the reliability of the American Experience Table of Mortality?
12. As the result of research by Dr. Banting in the laboratory of Professor MacLeod of Toronto University, with whom were associated Dr. Best and Dr. Collip, insulin was discovered. As result of this work, the highest recognition possible in medicine and science was given Professors Banting and MacLeod, with the award of the Nobel Prize for medicine. Insulin is used in the treatment of diabetes. Why is the discovery of tremendous importance in the field of life insurance?
13. There are two classes of hazards that tend to result in the classification of an applicant for insurance as substandard. Name the classifications, together with examples of each.
14. Compute the net premium for a term policy of $1,000 for one year with 20,000 entrants at the age of forty, using the American Experience Table and a 3 per cent interest rate.
15. In determining the rate for a substandard life risk many companies have a practice of giving numerical values to a large number of factors that have a bearing on the risk. The mortality of an average person is considered 100 per cent, and to this basic rate are added charges for unfavorable factors and credits for favorable factors. It is stated that there are certain forms of impairment which, taken together, have a more serious effect than the arithmetical sum of their individual rating. Discuss and give an example.
16. Show the method for computing the level premium for a whole-life policy.

To simplify the problem, take age of eighty, use the American Experience Table of Mortality, and a 3 per cent interest rate.

17. Compute the net annual level premium on a ten-year endowment insurance policy for $1,000 issued at the age of twenty-five, using the American Experience Table of Mortality and a 3 per cent interest rate.
18. The so-called "Guertin act" undertakes to provide uniform state nonforfeiture and valuation legislation in order to avoid conflicts between state laws and at the same time require the use of a modern mortality table. There has been some opposition in state legislatures to the enactment of the Guertin act on the ground that the use of the modern table will increase insurance costs. Discuss.

CHAPTER XXXIV

FUNDAMENTAL PRINCIPLES UNDERLYING LIFE INSURANCE

BASIC Concepts Modified. Because of the functions of life insurance, certain of the fundamental and basic principles that have been found to apply in other forms of insurance are modified under the life contract. Notably is to be found the modification of the idea that the insurance contract is strictly one of indemnity. There is likewise a new concept of insurable interest. The fact that the proceeds of the policy may be made payable to someone other than the insured introduces new and important features, and certain rules affecting assignment are peculiar to this type of contract.

Not a Contract of Indemnity. While the idea of indemnity is emphasized in writing life insurance, strictly speaking one cannot say that the contract is one of indemnity. In buying life insurance an insured undertakes to compensate his estate, dependents, or others to whom he is obligated for the loss occasioned in the event of his untimely death. However, when settlement is made, the beneficiaries under the policy are under no obligation to demonstrate, as a condition precedent to collecting the insurance, a direct pecuniary loss as a result of the decease of the insured. Because of the investment element of the policy, a principal sum accrues for the benefit of the insured, his estate, or beneficiary otherwise designated. It is quite possible, and frequently it is the case, that at the time the policy becomes payable because of the death of the insured, his value as a producer has long since ceased. As a matter of fact, he may have long been a dependent and a charge upon relatives. These circumstances have no bearing whatever upon the right of the designated beneficiary to participate fully in the policy in accordance with its terms.[1]

[1] Life insurance in the early days was widely used as a vehicle for gambling. This was not peculiar to life insurance alone, but life insurance loaned itself admirably to the purpose. Policies were taken out on the lives of important men in public life, leaders in military campaigns, and political prisoners. Frequently the interest on the part of policyholders in the gain they would derive from the death of the person upon whom the insurance was written was decidedly prejudicial to the best interests of the state. Early opposition to life insurance was not limited, however, to the insurance of the lives of important personages as a gambling feature. There were many who felt that the

The doctrine of insurable interest in the field of life insurance is considerably broader than in other forms of insurance. In most states this is governed by statute, and no uniform rule can be set forth. It is generally conceded, however, that so far as a person's own life is concerned he is not required to, nor can he set a monetary value upon it. To this end the courts have held that any person has an insurable interest in his own life for any amount. He may, therefore, buy insurance that is valid and enforceable in any amount which a company is willing to write and upon which he is willing and able to pay premiums.

Blood Relationship. In the case of blood relations it is the tendency of legislatures to be liberal, and an insurable interest is conclusively presumed, the law in all states allowing the presumption in the case of near relatives, such as husband and wife, or parent and child. Some states have raised the question of dependency as a requirement in the event that the relative is an adult and not a close relative. It is settled that the element of dependency taken together with relationship will establish an insurable interest.

Creditors. A creditor may have an insurable interest in the life of a debtor to the extent of the debt, and a creditor of a copartnership likewise has an insurable interest in the life of each copartner. In the case of creditors there is no fast rule as to how much insurance may be taken. The status of the creditor as beneficiary differs if the policy is one taken out by a debtor and is used as collateral for the loan, or if the policy is issued on the life of the debtor and purchased directly from the insurance company by the creditor. In the former case, it is generally held that the amount of the insurance may have no relationship to the amount of the debt. The debtor may take out a policy for any amount he wishes in excess of the debt and deliver it to the creditor as collateral security. When policies are so written it is held that the right of the creditor to the benefits under the policy is limited to the amount of the indebtedness. If, however, the creditor takes

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insurance on the life of a person was a thing to be abhorred, and in some instances it was absolutely prohibited by law.

A turning point in the development of life insurance was reached in 1774, with the enactment of the famous statute 14 Geo. III, c. 48, *An Act for Regulating Insurance upon Lives, and for Prohibiting all such Ins. except in cases where the Persons Insuring shall have an Interest in the Life or Death of the Person Insured.* This statute recognizes that it is possible to have an insurable interest in the life of another to such an extent that the beneficiary under the policy would not find the death of the insurant to be preferable to his life.

the policy out on his own volition and pays the premium himself without charging it to the account of the debtor, the debtor has no interest in the policy. In any case, the debtor must consent to the issuance of the policy, or he may, in fact, apply personally for the policy in the interests of the creditor. In the first case, therefore, when the policies are collateral to the loan, there can be no question of disproportion between the amount of insurance and the amount of the debt. In the second case, the amount of insurance which a creditor may properly carry on the life of the debtor must not be largely in excess of the amount of the debt. Such a policy has been held to be contrary to public policy.

Other Pecuniary Interests. Aside from the interests of creditors in the lives of debtors and those of dependents upon relatives from whom they may expect support or assistance, there are other relationships from which a pecuniary interest arises sufficient to establish an insurance interest under a life contract.

A substantial amount of life insurance is written insuring the life of a partner in a business venture for the benefit of the surviving partner or partners. Sometimes the proceeds of such a policy are payable to the firm, and in other instances the proceeds provide a fund with which the surviving partners acquire for themselves from the estate of the deceased partner his interest in the firm.

A corporation may insure the life of an important officer or other member of the organization in a key position. In the case of a small corporation, where the stock is closely held, the lives of stockholders may be insured, the proceeds to be used to buy the stock of a deceased stockholder, and the stock distributed among the survivors in accordance with a prearranged plan and agreement. Obviously a large corporation with widely distributed stock would hardly have an insurable interest in the lives of any of the stockholders, nor would the stockholders have an insurable interest in each other's lives.

In the case of employees, the question of insurable interest is dependent upon the value of the employee to the business. Obviously, one who could be easily replaced would hardly be one in whom the employer could reasonably claim an insurable interest. A chemist, however, working over a long period of years on research problems might reasonably be insured. This would be particularly the case if his experiments had not yet materialized but there were reasonable expectation of substantial benefits soon to be forthcoming.

It is reasonable to assume that a business might have an interest in other employees occupying key positions. In the event of doubt, however, when insurance seems desirable, valid insurance may be written when the employee himself applies for and secures the policy and designates the employer as beneficiary.

Designation of Beneficiary. The designation of a beneficiary in vague or uncertain terms frequently leads to litigation and difficulty. For this reason it is important that the beneficiary be designated in such a way as to avoid all possible confusion.

If a policy is made payable to the executors, administrators, or assignees of an insured, the proceeds of the policy are subject to the claims of creditors upon the death of the insured. If no beneficiary is sufficiently designated, the policy becomes payable to the estate of the insured. If the estate is designated as beneficiary, the distribution of the insurance may be made by will, or the insured may allow the insurance to be distributed in accordance with the inheritance laws of the state.

When a wife is designated a beneficiary without indicating the name, in the case of the death of the first wife, a second wife succeeds as beneficiary. In order to obviate any possible question, it is customary, not only to designate the relationship as wife, but also to state the name. Thus, Mary Smith, who married John Jones, becomes Mary Smith Jones. There can be no question as to the identity of the beneficiary. If the policy simply named Mary Jones as the beneficiary, Jones might, following a divorce, marry a second wife who had the same given name. The probability of a second wife having, not only the same given name, but also the same surname as the first is remote, however. In the case of an insurance made in good faith designating a wife as beneficiary, the insurance company in making payment is under no obligation to investigate the validity of the marriage.

When "children" are designated as beneficiaries, the term does not include grandchildren. When it is apparently the intent of the insured, the term "child" will extend to include an adopted child. An insurance policy made payable to wife and children includes all children, whether by the wife designated as beneficiary or by a former wife. If it is intended that only the children by the wife designated as beneficiary shall participate, the term "our children," or one having similar legal effect, should be used.

Control of Beneficiary. With respect to beneficiary, life insurance policies are written under two forms. Under the first, the beneficiary is named without right of change on the part of the insured, and the insurance in such cases is said to be "irrevocable." A second method of designating the beneficiary retains for the insured the right of change as he sees fit. The rights of the beneficiary under a life insurance contract vary in accordance with whether the policy is written under an irrevocable or revocable form.

If the right to change the beneficiary is not reserved to the insured, the beneficiary's interest is vested from the time the policy becomes effective. The courts have held that the policy, as well as the money to become due under it, belongs the moment it is issued to the beneficiary, and the person procuring the insurance has no power to transfer to any other person the interest of the named beneficiary. Any rights that the beneficiary may have, however, are dependent upon the conditions of the policy.

The courts have not been in agreement as to the successor in the event that an irrevocable beneficiary dies before the insured. It may be the intent of the insured, in the event that the designated beneficiary predeceases him, that the beneficiary's interest in the policy terminate. Unless provision is made to this effect, the insured may find himself faced with unexpected legal entanglements in the event that the interest of the beneficiary passes to his (the beneficiary's) estate. Policies, however, usually make provision for this contingency by providing that if a beneficiary predecease the insured, the interest of such beneficiary, unless otherwise stipulated, shall thereupon vest in the insured.[2]

When a policy is written with the beneficiary irrevocable, the usefulness of the policy to the insured himself is substantially curtailed. He cannot assign or pledge the policy, nor can he receive any of the other benefits, such as the loan or cash surrender value, without the consent of the beneficiary. The situation is not the same when the insured reserves the right of revocation. In such a case the beneficiary

[2] This follows the requirement of the New York law, which is set forth in the following terms: "Whenever the right of revocation has been reserved, or in case of the death of the beneficiary under either a revocable or an irrevocable designation, the insured, if there be no existing assignment of the policy made as herein provided, may designate a new beneficiary with or without reserving right of revocation, by filing written notice thereof at the home office of the company, accompanied by the policy for suitable endorsement thereon, and if no beneficiary shall survive the insured the policy shall be payable to the legal representatives of the insured."

has no vested right, but an expectation only. There are certain advantages and certain disadvantages in each of the forms. Because of this it is essential to recognize the usefulness of each in particular circumstances and, in procuring life insurance, to make the policy in this respect fit the particular needs of the insured.

If it is desired that the proceeds of the insurance be given to the beneficiary in the form of a gift, the irrevocable designation is the proper one. A husband may wish to create an estate for the benefit of his wife and children and so secure it that, in the event of future unforeseen financial difficulties, the accumulated value of the policy will be beyond the control of creditors. Such is the case when the beneficiary is irrevocable. On the other hand, if the insured wishes himself to make use of the policy for the purpose of giving security for a loan, or feels that the time may come when he may wish to surrender or transfer it and wishes to be under no obligation to secure the consent of a beneficiary, the proper form for him to use is that in which the right of revocation is reserved.

Either method of designating a beneficiary puts the benefits of the insurance beyond the reach of creditors of the insured when the beneficiary named is a third party. However, when a beneficiary has received money from the proceeds of life insurance, this money may be attached for the debts or obligations of the beneficiary himself.

Effects of Divorce. Where there is no statute covering the situation, a divorce does not deprive the beneficiary of rights under a life insurance policy. In some jurisdictions the statutes make provision for terminating the interest of a beneficiary following a divorce from the person whose life is insured. If there is no such provision in the statutes, it can readily be seen that when the beneficiary is made irrevocable under the terms of the contract, the beneficiary designated may retain his beneficial interest in the insurance following a divorce.

No Presumption of Survival. In the event of a disaster in which both the insured and the beneficiary lose their lives, there is no presumption as to the survivor. So far as the rights of the estate of each are concerned, much may depend upon establishing which of the two outlived the other.

The courts have held that the burden of proof rests upon the representatives of the beneficiary. For example, if a husband insures his life, naming his wife as beneficiary, and both are lost in a disaster under such circumstances as to raise a doubt as to which survived, if

the benefits of the insurance are to descend to the wife's estate, it must be shown that she actually survived her husband.

In some states statutory action has been taken with a view to eliminating the necessity of litigation. While all statutes are not the same, the simplest form of legislative enactment provides that when the insured and the beneficiary have died, and there is no sufficient evidence that they have died otherwise than simultaneously, the proceeds of the policy shall be distributed as if the insured had survived the beneficiary.[3] It is to be remembered, however, that in the absence of such legislation there is no presumption of survivorship in the case of persons who perished in a common disaster with no proof tending to show the order of death. The question of actual survivorship is regarded as unascertainable, and descent and distribution take the same course as if the deaths had been simultaneous.[4]

Rights of Creditors to Premiums. Since life insurance represents the accumulation of a fund for investment, the rights of creditors to the value of the insurance in the case of the insolvency of the insured are frequently perplexing. It has been established that there is no fraud of creditors on the part of an insolvent debtor when reasonable insurance premiums are paid upon policies and the beneficiaries designated are such dependents as wife or children. In the case of bankruptcy, under the terms of the Bankruptcy Act, the bankrupt is permitted to retain his insurance and keep it in force but is required to turn over an amount equal to the cash value to the trustee in bankruptcy. In this situation it is not necessary that the policies specifically state that they have a cash value, but if as a matter of fact such a value exists, it may be reached. The United States Supreme Court has ruled that if the state statutes exempt a policy, it is exempt in bankruptcy proceedings. In a few states statutes have been enacted specifically exempting policies with revocable beneficiary if the beneficiary is wife, children, or dependent relatives.

If the bankrupt is a third party beneficiary, even though he has a vested interest in the policy, it cannot be reached by his creditors. Finally, if the bankrupt's policy is written designating irrevocably a third party as beneficiary, the irrevocable interest of the third party cannot be reached by the creditors of the insured.

Right of Action of Beneficiary. The rule now in force in most

[3] For example, see Connecticut Statutes, chapter 266, section 677g, 1943.

[4] *Young Women's Christian Home* v. *French*, 187 U.S. 401 (1903).

states provides that in the event two parties make a simple contract for the benefit of a third party, the beneficiary may sue. In Massachusetts the contrary was held, and here it was the rule that no one but a party to a contract could sue upon it. So far as life insurance is concerned in Massachusetts and in most other states, the confusion of the general rules has been cleared up by statutes. It is now held that a third party designated by an insured as beneficiary under a life insurance policy may bring an action in his own name as if an actual party to the contract. Whether or not a state has covered the question by legislative enactment, it is now generally held, as an outgrowth of decisions in most of the states, if not all, that a third-party beneficiary may sue in his own name to protect any rights he may have under a life insurance policy.

Assignment. A life policy may be freely assigned, and the consent of the company is not required. It is sometimes provided, under the terms of the policy, that no assignment shall be effective until the company has been notified in writing. The courts have not construed such a clause as prohibiting an assignment. Its effect is to relieve the company of any responsibility arising out of the assignment before the receipt of written notice. As between the immediate parties, without notice to the company, an effective assignment is possible. It is not required that the assignee have an insurable interest in the life of the insured, though it is essential that the policy be so written as its inception that it is not invalidated for want of insurable interest or other element affecting the validity.

The United States Supreme Court has held that a valid life insurance policy is assignable like any chose in action. The court specifically states that to deny the right to sell a life insurance policy except to a person having an insurable interest is to diminish appreciably the value of the contract. When, however, it is apparent that the policy was procured designating a beneficiary with an insurable interest but transferred to an assignee without an insurable interest, with the intent to provide a wager contract, the courts have held this to be as objectionable as to issue a contract that is in the first instance a wagering contract.

Although the right of assignment is well established, there has been considerable uncertainty concerning the means for its accomplishment. This was the outgrowth of differences in practices by the various companies as well as statutory differences in the various states.

Insurance companies, in the ordinary course, were prepared to provide assignment forms aceptable to them; but since these forms were drawn from the point of view of the insurance companies, they did not always meet the requirements of the assignee. With the increase in volume of life insurance in recent years and with its increasing use as collateral or as a basis of credit, it became increasingly apparent that assignment uniformity would reflect to the benefit of both insurance companies and lending institutions. With this thought in mind, the Association of Life Insurance Counsel, at its December 1938 meeting, approved a standard form for use when a bank is the assignee. The American Bankers Association co-operated with the Association of Life Insurance Counsel in its development. It was recommended by the Association of Life Insurance Counsel that life insurance companies accept the form when requested by a lending institution to do so; and the work of the committees was, in due course, ratified by the American Bankers Association. The form is now made available to lending institutions and bears the certification: "Form Approved by Bank Management Commission, American Bankers Association." The form is as equitable as could be devised, and its general use has tended to introduce a wide degree of uniformity in a field that has heretofore been conspicuous for its lack.

Right To Trace Misappropriation. When a defrauded person is able to trace his funds to the payment of life insurance premiums, his rights to the benefits of the policy precede those of the beneficiary. In such cases a difficulty sometimes arises as to what proportion of the misappropriated funds was used to pay insurance premiums. If the premiums were paid entirely from the funds of the party defrauded, he is entitled to the entire proceeds of the policy; otherwise, the defrauded party may secure from the proceeds of the policy only so much as is necessary to reimburse himself.

The Doctrine of Warranties. Life insurance policies were formerly written with a clause making the statements in the application to have the force of warranties. Under the harsh doctrine of warranties, if any of the statements made in the application were not strictly and literally true, the company had the right to cancel the policy. The fact that the warranty in no way contributed to a loss did not change the situation. Neither did the good faith of the insured afford any relief.

It is obviously very difficult to answer all the questions in an appli-

cation for a life insurance policy and have the answer so literally correct that a trained legal mind would be unable to find some ground for disputing a claim. The law is most jurisdictions now requires, in the absence of fraud, that statements in the application be considered representations and not warranties. Most companies incorporate this provision in their policies. Representations made in good faith and without intent to defraud do not have the effect, if not technically correct, of affording the company grounds for canceling the policy or refusing to pay a claim. A deliberate misstatement made with the intent to defraud, or in any way involving bad faith, is a basis for voiding the policy.

Murderer Beneficiary. It is well settled that the beneficiary of a life insurance policy cannot recover on the policy if he has feloniously caused the death of the insured. This rule is based upon the principle that one may not profit by his own criminal act.

If the beneficiary is the cause of the death because of an accident, or because he is mentally incompetent and irresponsible and, therefore, not guilty of a criminal act, his rights under the policy remain unaffected.

Trustee as Beneficiary. Life insurance contracts are drawn in a number of forms with a view to providing a policy to meet any ordinary need. The fact that certain classes of beneficiaries, notably women and children, because of a lack of experience in investing and disbursing large sums, have not been able to administer life insurance benefits wisely, has led to the incorporation of various optional methods of settlement and the writing of policies payable on a straight-income basis.

A life insurance policy, since it is a contract, permits of no discretion in the distribution of the proceeds after the policy matures. The company is obligated to follow the policy terms to the letter and is permitted to exercise no discretion in changing the terms of the agreement to meet change circumstances or to assist the beneficiary through an unforeseen emergency. When the proceeds of the insurance are to be used for a purpose requiring some administration and discretion, the life insurance trust finds its chief use. The proceeds of the insurance are made payable to a trustee for administration and disbursement, following the term of an agreement entered into between the insured and the trustee.

The Trust. When the legal title to a property is in one or more

persons, and the right to enjoy the proceeds and benefits of the property is in another person, the property so held is "in trust"; the holder of the legal title is the "trustee," and the persons enjoying the beneficial interest are the "beneficiaries," or the *cestui que trust.* The property held by the trustee is called the *res,* unless it is money, in which case the term "trust-fund" may be substituted. In the case of life insurance the person creating the trust is the "insured," or the "creator," and the writing setting forth its term is called the "trust agreement," or is sometimes referred to as a "declaration of trust."

While in order to create a trust one must have the legal capacity to pass the title to property, there is no limitation to the capacity of the beneficiary to hold property. For this reason the trust is admirable for providing the income from property to beneficiaries who because of age, temperament, inexperience, or any other reason are not in a position to administer their own affairs to advantage.

Period of the Trust. The length of time which the proceeds of life insurance should remain in the hands of trustees will depend upon the circumstances of each particular case. As a general principle it is considered unwise to continue a trust beyond the period of its actual need. Thus, if the proceeds of a life insurance fund are trusteed for the benefit of minor children, it is to be presumed that the need will terminate when the children become legally of age or at least at a reasonable time thereafter. To continue a trust unduly long may quite possibly defeat the best interests of the beneficiary.

Another factor operating against the creating of a trust to run for an undue length of time is the general rule of law, modified to a degree in some jurisdictions, which limits the period of a trust for the benefit of individuals to the duration of a life or lives in being at the time of the creation of the trust and twenty-one years thereafter. In the case of a life insurance trust, the trust begins from the date of the agreement. The limitation does not apply in the case of charitable organizations, and a trust in which church, school, hospital, or established charitable institution is the beneficiary may continue indefinitely.

Life Insurance Trusts. When the proceeds of a life insurance policy are paid under the terms of the contract to a trustee, a life insurance trust has been created. The terms of the trust may be complicated and technical and involve any condition the trustee is willing to assume so long as there is no legal objection. A trust may be

either a "living" trust or a "post-mortem" trust. Instead of the foregoing, the terms "funded" and "unfunded" are sometimes used.

Under a post-mortem trust the proceeds of the insurance are paid to the trustee for administration upon the death of the insured. During his lifetime the premiums are paid by the insured. The living trust differs in that the insured during his lifetime deposits with the trustee a sufficient amount of cash, securities, or other property to provide therefrom sufficient income to meet the premium payments. Upon the death of the insured the property so deposited is disposed of, together with the proceeds of the insurance, according to the terms of the trust agreement.

A form of the funded or living trust is the cumulative or investment trust. The purpose of such a trust is to accumulate an estate through the combination of insurance and saving. The insurance is trusteed, and cash, securities, or other properties are added. Additional cash from time to time is added to the trust to be administered by the trustee. Premium payments are made from income supplemented when necessary by payments by the insured, it being the aim of the creator to place ultimately in the hands of the trustee sufficient property to fund the trust completely.

The Trustee. A number of life insurance companies are willing to act as trustee, or the creator may designate such organization or person as he may select who may be willing to serve. A large number of banks and trust companies have set up organizations for carrying on a trust business, and these are frequently preferred because, being conveniently located, they afford the beneficiary and trustee the opportunity of personal contact.

If the life insurance company assumes the obligation of trustee, administration is made without charge. A further advantage is found in the safety secured through the wide diversification of the insurance company's investment portfolio. On the other hand, as an offset, since the funds of each trust are not segregated and administered separately, the return earned for a particular trust is the average earned by the company. When the funds are placed with a trust company, they are managed as separate funds, and a fee is charged for the service. There is no guarantee as to principal, any increase in the principal accruing to the benefit of the trust and any shrinkage being absorbed by the trust. Likewise, whatever income is earned through the management of the fund accrues, less fees, to the credit of the

trust. The safety of the principal and the amount of the income depend, therefore, upon the successful handling of the particular fund by the trustee.

Discretionary Trusts. A trust may be "legal" or it may be "discretionary." Under a legal trust the trustee is limited in his investments to securities approved for trust by the state in which the trust is created. Under a discretionary trust the creator leaves the selection of investments entirely to the discretion of the trustee. It is usual to provide, when complete discretion is allowed, that the trustee have the same power and authority in handling the fund as the creator of the trust would have if living and using it for the same purpose.

Closely allied to the use of discretion in investments is the use of discretion in the administration of the proceeds. The most careful planning cannot foresee every emergency, and the most satisfactory trust agreements, in which dependent persons are the beneficiaries, are those which give the trustee sufficient power to act in a crisis as he believes would meet with the approval of the creator of the trust if he were alive and could be consulted.

Control of Trust. Depending upon whether or not the creator of the trust under its terms has the right or not to take back for his own uses the trusteed property, a trust is revocable or irrevocable. The creator of a living trust may reserve to himself the right to enjoy all or part of the income during his lifetime, or he may reserve the right to change the beneficiaries or otherwise alter the plan. Such conditions do not make a trust revocable. If the creator cannot terminate the trust and secure the return of the trusteed property without the consent of another, the trust is irrevocable.

The extent to which control of the trust is retained by the creator becomes of importance for the purpose of computing the federal estate tax. If the trust is irrevocable and the creator retains none of the rights of ownership, such as the use of the income or the right to change the beneficiary, neither the funded part nor the proceeds of the insurance are subject to the tax.

FOR REVIEW

1. B insures his life for $10,000, designating his wife as irrevocable beneficiary. He has been allowing the dividends to purchase additional insurance. This year, because of financial reserves, he wishes to utilize the dividends to reduce premium payments. He is advised by a friend that

the beneficiary has a vested interest in all the values of the policy and accordingly must consent to his decision to apply dividends against the premium. What is your opinion?

2. B carries life insurance in the amount of $15,000, naming his wife as beneficiary. On a certain day the wife shoots and kills her husband and immediately thereafter takes her own life. The heirs of the wife claim the proceeds of the policy, as do the heirs of the insured. What is the determining factor covering the payment of this insurance?
3. A is the husband of B. A carries $50,000 insurance for the benefit of B. A's only other living relative is a brother. B's only heir is a nephew. Both A and B perished in an aviation disaster. The brother of A and the nephew of B claim the insurance. In your opinion, to whom should the insurance be paid?
4. X and Y are in no way related. They came to this country as immigrants at the age of sixteen, and because of their common interests a friendship developed lasting through life. X married and Y remained single. Y wishes to insure his life, naming X's children as beneficiaries, but is told that he cannot do this since, as a matter of fact, no blood relationship exists. Can you contribute anything to clarify the situation?
5. In attempting to destroy a building by fire to defraud the fire insurance companies, the wife of M is accidentally burned to death. M is named as beneficiary in his wife's life insurance policies. What is his position?
6. Y insures his life for the benefit of his wife and children. Upon his death, will only the children living at the time the policy was issued participate, or will the benefits extend to include children born after the insurance of the contract?
7. Can a life insurance policyholder change the beneficiary named in the policy by will?
8. X secures a life insurance policy naming Y a beneficiary. Later X murders Y. Under the terms of the policy, if the beneficiary predeceased the insured, the interests of the beneficiary vested in X. The insured is executed for his crime. May the estate of X recover the insurance?
9. C insures his life for $50,000. It is his intention that his son, aged ten, secure the benefit of the proceeds of the policy. Because the son is a minor, C determines to have the proceeds of the policy administered by a trustee. The question presents itself as to how long the trust should run after the son becomes of age. What is your opinion?
10. B is a graduate of X University. He wishes to establish a fund through the agency of life insurance to provide for an annual scholarship in memory of his wife. He directs that the proceeds of a life insurance policy be made payable to whomever shall be occupying the position of treasurer of the university as trustee. For how long a period may he direct that the trust continue?
11. B, upon the occasion of the birth of his first child, insures his own life for $100,000 and provides that the proceeds be placed in trust for the benefit of all children during their lifetime, and to continue for the benefit of all

grandchildren for a period of twenty-one years after the death of all his own children. Discuss such a provision from the point of view of its legality.

12. B insures his life for $100,000, the proceeds to be used to set up a trust fund for the benefit of a certain orphans' home. You have been designated trustee to administer the funds and pay the income quarterly to the directors of the home. After you had made the second annual payment, the home was destroyed by fire and because of the condition of its finances it could not be rebuilt. As a result, the identity of the home as a charitable organization was obliterated. To whom now must the proceeds of the fund, of which you are trustee, be paid?
13. B insures his life, naming his wife as beneficiary. Five years later B is charged with embezzlement and found guilty. The firm from whom the money was stolen claims the proceeds of the policy. What is the position of the wife?
14. B's insurance is made payable to "my wife and children." Upon B's death his wife and their children file claim for the insurance. Children by a former marriage of B claim they have a right to participate. Is their claim supportable?
15. X names his wife and children as beneficiaries of his life insurance. B, one of the children, claims that the insurance should be distributed equally, but the wife contends that the insurance should be divided in accordance with the statute governing the distribution of inheritances. What is your opinion?

CHAPTER XXXV

LIFE INSURANCE CONTRACTS

FIRST Contracts for a Term. It has already been noted that the earliest form of life insurance contract of which we have a record provided insurance for a term. With the development of incorporated insurers in 1720, life policies were commonly written but, as before, for a term. One of the earliest policy forms of which we have a copy was written by the London Assurance in 1720. This policy provides insurance for one Thomas Baldwin on the life of Nicholas Browne for a term of twelve months.[1]

A policy written for a term follows the form of other contracts of insurance. At the end of the policy term the insuring company is under no further obligation to the insured. With the development, in recent years, of the investment feature as an important part of the life insurance contract and the increasingly wide range of usefulness of life insurance, the term policy forms one of the less important of the classes of life policies issued today.

"Term insurance" is precisely what the name would imply, insurance for a term. This may be contrasted to whole-life insurance, which is permanent insurance and covers as long as the insured shall live. If term insurance is written for a year, it provides protection equal to the face of the policy for one year, no longer. If it is written for five years, the insurance covers for five years. It is written for life expectancy, the policy covers for the period of the insured's expectancy of life as shown by the mortality table. At the end of the term, whether for a year, five years, or any other period, long or short, coverage terminates, and the policy has no value whatever. It is comparable to a fire insurance policy or other property insurance

[1] The policy reads: "The said Governor and Company, therefore, for and in Consideration of Five Guineas per Cent to them paid, do assure, assume, and promise that he the said Nicholas Browne shall by the Permission of Almighty God, live and continue in this Natural Life, for and during the said term and Space of Twelve Month to commence aforesaid. Or in Default thereof, that is to say, in case he the said Nicholas Browne shall in or during the said Time, and before the full End and Expiration thereof, happen to dye or decease out of this World by any Ways or Means whatsoever, That then the abovesaid Governor and Company will well and truly satisfy, content, and pay unto the said Thomas Baldwin his Executors, Administrators, or Assigns, the Sum or Sums of Money by him Assured. . . . ."

coverage which is written for a term. If the contingency insured against happens, the policy pays in accordance with its terms. If the contingency fails to happen, the premium paid is fully earned, and the company at the end of the term is under no obligation to the insured.

Uses of the Term Policy. The term policy provides protection for a period, and upon expiration the company owes the insured nothing. If the insured dies during the term, the amount of insurance is paid to the beneficiary.

Term insurance finds its principal use in providing protection during a period of unusual financial strain. An individual may permit himself to assume heavy obligations as part of a business venture. He is satisfied that, given his health, he will succeed in working his affairs to a satisfactory and profitable conclusion. An untimely death and forced liquidation might seriously cripple his estate. To forestall such a situation, the prudent businessman, whose insurance program is otherwise satisfactory, will frequently buy a term policy to cover the amount of the unusual liabilities for the length of time he estimates will be required for their liquidation. The rate being low, protection is furnished at a minimum cost during the period of uncertainty and risk. When the venture has reached a profitable stage and heavy obligations are cleared, the insurance may be discontinued without loss.

A second use for term insurance is to provide a fund for the liquidation of some particular debt. Not infrequently a term policy is carried in connection with a mortgage encumbrance upon the home. Plans for the payment of the mortgage debt may be interrupted by death. In order that dependents may find themselves possessed of a home without encumbrances in the event of the untimely death of the wage earner, a term policy is carried to provide the necessary funds for liquidation.

Term insurance finds an important use in supplying adequate insurance facilities at a low cost during a period when a large amount of insurance is most needed, but when funds for meeting the cost are not available. A young man with dependents who is recently graduated from college wishes the maximum insurance that his money will buy. He therefore buys term insurance with the privilege of converting it to another form at a later date. In this instance, his term policy is, in effect, an option upon a permanent insurance program,

which the insured feels at a later date he can adequately handle. In the meantime he has provided his dependents with a maximum of protection.

A final use of term insurance is to provide protection for an insured who wishes to be insured at once, but who, for some particular reason, wishes his policy to be dated and his premiums to come due at a future date. Assume, for example, that an applicant for insurance has a large sum due from investments on January 1 and July 1. During the month of September he decides upon an insurance program which he wishes to become effective at once. He wishes, however, to pay his premiums semiannually on January 1 and July 1. This can be effected by dating his policy January 1 and providing term insurance from the time of the application to the effective date of the permanent policy.

Much has been said recently about term insurance and its relative merits as compared with a whole-life plan written on a level premium basis. Advocates of term insurance as a permanent program either make the statement boldly or at least make it by implication, that level-premium insurance represents a higher charge for the same coverage than is obtained by buying yearly renewable term insurance.

Term insurance has unquestionably made a tremendous appeal on the basis of price when it has been definitely "sold" as a part of a plan to twist existing business to the evident benefit of the seller and a possible and very probable loss to the purchaser. It is not unnatural that the buyer, not trained in the intricacies of the business of insurance, should become confused.

Advocates of term insurance suggest as the most economical form of insurance the purchase of a one-year renewable term contract. The cost of this insurance in comparision with a level-premium plan is low in the younger age brackets, but as the years go on the cost becomes increasingly higher, until in the later years of life it is, for all practical purposes, prohibitive. Insurance written on this basis follows the natural premium. Under this form the premium income each year pays the current death claims. Thus, in the younger age groups the death rate is low and the premium charges are correspondingly low. In the older age groups the death rate becomes progressively higher and higher, and the effect is felt in a premium that increases from year to year. The attraction, because of the apparently low premium in the early years, is entirely forgotten in the later years

of life and the abnormally high premium becomes magnified into an almost insurmountable obstacle. This is so because in the earlier years the insured, owing to his ability to earn, is in a better position to pay his premiums, and the premiums are low because the risk during these years is slight. As he reaches the age when his ability to earn has a downward trend, premium charges are shooting up along a curve that ultimately becomes perpendicular. Throughout the history of insurance this has always had one effect. Policyholders, as they grow older, become bitterly resentful of the increasing premium payments. No matter how painstaking the explanation of the natural premium trend, policyholders have tended to discount the high premiums of later years as too remote to be of importance when attracted in their younger years by the comparatively low premium charges. There is a tendency to wholesale abandonment of the insurance plan when premiums reach a level where the insured cannot or will not pay them. This, of itself, would have no adverse effect upon the actuarial soundness of the plan but for one other factor. Sick men do not cancel insurance, regardless of the burden of the premium. Only those who feel themselves to be in exceptionally good health do this. This results in adverse selection. In simple, everyday language, it means that as the group grows older the insurance company has a group of risks with an abnormally large number suffering from tuberculosis, heart trouble, or other incurable ailments, while those in sound health continue to abandon their insurance. The ultimate result has inevitably been a total of claims far beyond the average mortality expectation and far beyond the ability of the company to pay on the basis of its premium income.

The unfortunate effects of the use of term insurance for a whole-life plan are: first, it does not really insure for the period of a whole life, for the majority of the policyholders are forced to terminate their coverage; and, second, from the standpoint of the companies, the effect of unfavorable selection has made renewable term insurance as a whole life plan impossible on the basis of mortality table expectations.

We sometimes hear it stated, on the other hand, that term insurance is an inferior type of coverage. It is stated that the buyer of insurance gets exactly what he pays for. If he buys a cheap coverage, using "cheap" in the sense of inferior, he cannot expect to get the better product that a higher premium will buy. The reasoning is

not sound. The facts of the matter are that the term contract is as safe, as adequate, and in every sense as satisfactory for the purposes for which it is devised as any one of the many types of contracts offered by life insurance companies.

No life insurance company has the slightest objection to the use of the term policy, nor would any underwriter, if he possessed even an elementary knowledge of life insurance theory, show any opposition to the term policy in those situations where its use is indicated. It is not the term policy to which opposition is expressed, but to its misuse.

In spite of everything that may be said, the one important point to consider is the fact that term insurance was not designed to be permanent insurance. For temporary protection to cover an emergency, the policy is admirable. To augment a permanent life insurance plan during a period when the need for coverage is greatest, term insurance is indicated, and a number of combination policies have been worked out by life insurance companies making judicious and generous use of the principle.

One-Year Term Policy. Term policies are written in their simplest form for a period of one year. The premium charge is the natural premium for the age. It follows, therefore, that if the policy is continued in effect from year to year the insurance cost has an upward trend.

Life insurance companies have extended certain privileges in connection with the writing of term insurance with a view to encouraging insureds under this form to convert their coverage to a more permanent form. The one-year term policy may ordinarily be renewed for a given number of years without medical examination. The policy may likewise be converted into a permanent type policy within a given number of years without medical examination. The particular disadvantage of all term insurance it to be found in the possibility of allowing the policy to run to a point where another medical examination is required and, upon application for further insurance, the applicant is rejected or rated as an impaired risk.

Five-Year Term Policy. Policies are issued for a term of five years with the privilege at any time during the term of converting the insurance without medical examination to a permanent form. Unlike the yearly renewal form, a level premium is charged instead of a premium increasing annually, following the natural rate.

This type of term insurance finds particular favor with those who

intend to make the coverage a part of a permanent program but require for their immediate needs low-cost protection. Through the purchase of this policy, protection is afforded with the assurance that any impairment in health during the policy term will not have an adverse effect upon converting the coverage to a permanent form.

Special Term Policies. Term insurance finds its primary use in providing a means whereby an applicant may secure an option on the amount of permanent insurance he deems necessary for his needs before he reaches a position to pay for it. There are, however, a number of other situations for which term insurance is admirably effected, and numerous special policies have been devised to fit these needs.

With the advent of the social security program term insurance has been written to correlate the insurance protection with the provisions of the Social Security Act. Policies are available on a 5-, 10-, 15-, and 20-year basis with liberal convertible privileges. Term insurance may also be written on an annual renewable basis to the age of sixty-five or on a level premium covering to the age of sixty-five. In the first instance, the annual premium charges increase each year, following the natural premium trend, and have the disadvantage, which attaches to all natural premiums, of becoming extremely high in the advanced ages. In the case of the level premium, the cost is higher than the natural premium in the first years, but it remains constant because of the fact that, in a level-premium term policy running over a long period of years, it is obviously necessary to build up a reserve, such policies, contrary to the usual practice in term insurance, provide for cash and other nonforfeiture values.

Converting Term Insurance. When an insured carrying a term policy with the privilege of converting wishes to exercise his right, he has two options. The new policy may be dated at the date of the conversion, in which case the premium is charged on the basis of the then attained age of the insured, or the policy may be dated back to the original date of the term policy. If the insured exercises the second option, he will pay subsequent premiums on the basis of the younger age. He must, however, make up the difference between the term premium and the premium charge for the new policy, plus interest, from the date of the issue of the term policy until the date of conversion.

Ordinary Life Policy. The major part of all the business of life insurance is written on the ordinary life form. The policy, some-

times termed a "whole-life policy," provides, in consideration of the payment of an agreed premium, payment of the amount of the insurance to a designated beneficiary upon proof of the death of the insured. In its simplest form, the whole-life policy undertakes to pay an agreed amount upon the death of the insured. The premium is computed on a level basis and is payable annually during the lifetime of the insured. Arrangements may be made for semiannual or quarterly premium payments, when desired.

The popularity of the ordinary life policy is based primarily upon the fact that it is the lowest-cost form of permanent insurance. Unlike the term policy, which must eventually be converted or expire, the ordinary life policy provides a lifetime protection at an annual cost predetermined at the inception of the policy.

The policy is particularly popular with people of moderate means who are dependent largely upon salary or wages. For example, a young man with wife and children depending upon him is primarily interested in a maximum amount of insurance for the proportion of his income avaliable for the purpose. He may purchase for a time a term policy, but when he seeks a permanent program the ordinary life policy appeals on the basis of cost.

Modifications of Ordinary Life Form. To offset the advantages of the ordinary life policy, which are its moderate cost, level premium, and the savings element, there are certain shortcomings. There is a tendency for those influenced primarily by cost to be attracted from the ordinary life policy to the term policy, thus unduly delaying the inauguration of a permanent program. To supply an immediate permanent policy with an initial premium less than the ordinary life premium, a modified life policy is offered.

Again, many object to the requirement of the ordinary life policy that premiums be paid until death. It is pointed out that in the declining years of a life productive capacity diminishes. To this end it is considered desirable that premium charges cease after reaching old age. To meet this need, a limited-payment life policy is offered.

Finally, an individual may desire a certain sum payable at his death for a designated purpose. He may be wealthy and desire to be relieved of the care of meeting annual payments. For this class, the single-premium policy is offered. The amount charged for each form varies but is based upon mortality calculations and the computation

of interest, and each charge is the mathematical equivalent of the other.

Modified Life Policy. This policy is permanent in form but provides for a term insurance at a lower cost than the ordinary life premium does and then continues on a level basis at a rate slightly higher than the ordinary life cost. In the case of a policy affording a premium for the first five years at one-half that required for the remaining premium payments, the lower cost in the beginning must be compensated for by a higher subsequent cost, since the different payments are mathematically equal. The advantage of this policy is to be found in the fact that it is permanent, that it provides low-cost insurance for a term, and finally that the subsequent premiums are considerably less than would be required for a new ordinary life policy.

This type of policy permits of considerable modification. One form that has met with favor starts with a low first-year premium, each successive premium becoming higher until the fifth year has been passed. Premiums from the fifth year on are level, though they are slightly higher than would have been the case had a level premium been charged from the inception of the policy. The progressive premium during the first five years appeals to the person who finds himself forced to make drastic readjustments during a business crisis. He may foresee his ability to pay a larger premium a few years hence, but during the readjustment period insistent demands absorb his available funds. Rather than risk carrying at a level premium only as much insurance as he has funds to buy under an ordinary life form, increasing the amount as he is able, he may carry a much larger amount at the very beginning and presumably at the time of his greatest need.

Limited-Payment Life Policies. These policies afford exactly the same protection as is afforded under an ordinary life form. The point of difference is to be found in the fact that, after premium payments have been made for a stipulated term, no further payments are required to keep the policy in force. No payment is made either to the insured or to the beneficiary at the end of the term, and, as in the case of ordinary life policies, the insurance is paid at the death of the insured.

There are five widely used limited-payment forms. These pro-

vide for the payment of premiums over periods of ten, fifteen, twenty, twenty-five, and thirty years. Which of the forms an insured will buy depends upon his age at the time the insurance is written and the age at which he wishes further premium payments to terminate. Obviously the fewer payments in the term, the higher the premium charge.

The evident disadvantage of this type of policy lies in the fact that the same premium charge will buy a substantially larger amount of insurance under the ordinary life form. On the other hand, its principal advantage lies in the fact that an insured is enabled, by increasing his premium during the years of maximum earning power, to be relieved of payments when his earning capacity has been curtailed.

It has sometimes been stated in criticism of limited-payment insurance forms that the coverage is expensive. This is not in a strict sense true. To be sure, premiums as they are paid are higher than the ordinary life premium. If the insured dies while premium payments are being made, he has, in fact, paid more for the benefits than he would have paid under an ordinary life form. On the other hand, it is equally possible that as the years go by the cost to the individual will be less than would have been required under the ordinary life form.

Single-Premium Policy. Instead of paying for an ordinary life policy on an annual level-premium basis, one may pay the premium in one sum as, indeed, one may may for other policy forms. Such policies are not in great demand, but they are admirably suited to meet the needs of special situations.

An insured may desire that a certain sum be made immediately available upon his death. This may be for the purpose of paying estate taxes and expenses of administration, of endowing a charity, or of providing a sum in cash for dependents. A wealthy man may prefer to accomplish a purpose through the agency of life insurance by paying, once and for all, a single premium and thereby being relieved of all further obligations.

Another use for the single-premium form is found when a wealthy individual wishes to guarantee an estate of a definite amount. Foreseeing for himself the possibilities of the same reverses that have come to others, the insured relieves himself of a possible burden of in-

surance premiums in a time of financial distress through the purchase of a single-premium policy in a period of prosperity.

The chief advantage of this form is found in freeing the insured from the care and burden of future premiums. Its chief drawback is found in the large sum of money immediately required to pay for the policy, coupled with the fact that in the event of an early death the cost of the protection becomes abnormally high in the light of the cost of the same protection under an ordinary life policy with the premium payable annually.

Income Policies. Policies of this class differ from the ordinary life or limited-payment policy only in the method of making payment to the beneficiary. Instead of making a lump sum settlement upon the death of the insured, the policy provides an income for a definite number of years or for life.

Depending on the conditions of the policy, the payments may be made monthly, quarterly, or on any other satisfactory basis. The policy may provide for the payment of income for a definite term, with the provision that if the beneficiary dies during the term, the payments shall be made to a second beneficiary or to the insured's estate. Policies under this form are written to provide income for periods of five, ten, fifteen, or twenty years.

Since it is quite possible that a beneficiary may outlive the period provided in a policy for the payment of income, the insured may provide protection for his beneficiary against such a contingency upon the payment of a slightly higher premium than is required when a definite term is indicated. Under this form, income is guaranteed as before, for a term, but it is further provided that if the beneficiary outlive the term indicated in the policy, the income shall continue for life.

Some policies provide the option of a lump sum settlement. The lump sum amount is determined by reducing the installments guaranteed to a present value. The policy finds its widest use in providing protection for dependents, such as wife and children. The option of a cash settlement provides a means for raising money in a great emergency. There is, of course, always the possibility that the option may defeat the purpose of the policy.

Principal and Income Policy. This policy provides an income for the life of one beneficiary upon the death of the insured and the pay-

ment of the principal amount to a second beneficiary. The income payable to the first beneficiary is determined by a guaranteed rate upon the principal amount. Thus, a principal and income policy for $40,000 with a 3 per cent income would pay the first beneficiary $100 a month for life. Upon the death of the recipient of the income, a second beneficiary, or if desired the insureds estate, would receive the $40,000 without deduction.

If the first beneficiary dies before the insured, the amount of the insurance is paid directly to the second beneficiary upon the death of the insured.

An income provision of this type may be written with either an ordinary or a limited-payment life. A slight addition to the regular premium is made to carry the income feature. When the beneficiary who is to receive the income predeceases the insured, the premium charge from that point on is reduced to the regular premium for the type of policy carried.

This policy finds favor when an insured desires to care for one particular beneficiary for life and then to have his estate distributed. A man with four children might provide a life income for his wife and upon her death a distribution of the insurance to his children. By so doing he accomplishes the same end sought frequently through the agency of a trust. The advantage of the plan over a trust lies in the fact that the principal is guaranteed against shrinkage and a definite income insured.

Installment Insurance. Not unlike the income policy is the installment policy. Instead of providing a certain income over a designated period, or for a designated period and for life, the policy designates a principal sum to be paid to the beneficiary in installments.

Policies of this type may provide for the payment of the insurance in from five to twenty equal amounts. Installments may be made payable annually or in shorter periods. The policy is used, in much the same manner as the income policy, to prevent the placing of a large sum at one time in inexperienced hands. It may also be used to provide an annual gift over a number of years to a charity, or a gift to some person at a particular season, such as Christmas-time, or at a date having particular significance to the donor.

Endowments. It was natural in the consideration of life contingencies and the provision for dependents that the problem of providing for the old age of the insured should be presented.

The ordinary life policy provides for the payment of the amount of the insurance to a designated beneficiary upon the death of the insured. The pure endowment reverses the process and pays the amount of the insurance only in the event that the insured lives a specified term. The amount of the insurance is paid to the insured himself if he is living at the end of the period; otherwise, the company pays nothing.

There are few uses for a pure endowment. Most endowment policies offered by insurance companies incorporate the features of a term life insurance policy. When so written, if the insured dies during the term, the amount of the insurance is payable to a designated beneficiary. If he is living at the end of the period, he himself receives the amount.

Pure endowments are sometimes written for children. When it is desired to set up a plan to provide for a child's education, dower, or other specific purpose, this form provides a low-cost means. Under the form, nothing is paid if the child dies before the end of the period, though upon the payment of a slightly higher premium the company will return premiums paid.

The Endowment Policy. All life policies, with the exception of term insurance and the pure endowment, combine the elements of investment and protection. While ordinary life policies emphasize protection, the endowment policies give emphasis to both features. The endowment policy enables the insured to build up a fund that, in due course, if he lives, will be available for his own uses, and at the same time it protects his beneficiary during the period of accumulation.

Endowment insurance is written under a number of different forms, each designed to meet particular needs. The terms for which they are written may vary from five to twenty-five years, or they may be written to mature at a designated age, such as sixty or sixty-five years. Again, there are limited-payment endowments. For example, an endowment payable at death or at the end of forty years may be written so that premium payments stop at the end of twenty years.

The investment feature of endowment insurance makes the premium charge substantially higher than for ordinary life insurance. Obviously, the shorter the term, the higher the premium. A man carrying a ten-year endowment for $20,000 who dies during the term,

say at the end of the ninth year, leaves no more insurance to his beneficiary than if he had taken out an ordinary life policy for the same amount. His annual insurance premium, however, is substantially more. To express it differently, for the same premium that the insured pays for an endowment policy he could secure a much greater protection under an ordinary life form. Because of this, it is important to recognize the uses of endowment insurance and not to buy it when protection of a beneficiary is the purpose for which the insurance is carried. The endowment policy is indicated when saving for a particular purpose is to be coupled with insurance.

The first use of an endowment policy is to provide for the old age of the insured himself. There are many who, because of their nature or habits, find saving money irksome and difficult. On the other hand, these people find it easy to meet obligations. An insurance premium is regarded as an obligation and is paid regularly at fixed periods. Thus, an insured may institute a savings program and accumulate a fund that might otherwise prove impossible. The reminder of the insurance company is all that is necessary to keep payments regular.

Endowment insurance is used to accumulate a fund for a particular purpose. Notable in this class are policies designed to provide funds for the education of children. Again, an insured may be desirous of making a substantial gift to a college, church, hospital, or some charity. Through the agency of an endowment policy he may accumulate the sum gradually over a period of years and, at the same time, be assured that the sum will be forthcoming without drain on his estate in the event of an untimely death. A final use may be mentioned. In connection with the purchase of a home, an endowment policy may be purchased to pay the mortgage when due. In case of death of the insured during the term, a sum sufficient to clear the encumbrance on the home is forthcoming from the insurance.

Of all the policies offered by the life insurance companies, perhaps none has caused greater misunderstanding than the endowment contract. Much of the criticism that is leveled at endowment insurance is based upon the high premium charge. It is pointed out that if an insured buys a twenty-year endowment policy, lives for nineteen years and then dies, his beneficiary gets no more than would have been paid if term insurance for the period had been carried. The conclusion suggested by this type of argument would lead the thought-

less insurance prospect to believe that the endowment policy carries a premium entirely out of line with the risk assumed. This is not the case.

It is perfectly true that if the endowment policy is purchased purely for insurance, there may be a misuse of the contract and the insured may be paying more for his protection than is necessary. Like other insurance contracts, the endowment policy has a very real use. In the situations for which it is designed there is no other contract that will serve as well. To attempt to use it in other situations may result in a poor distribution of that proportion of the income set aside for insurance.

The insurance element in the endowment policy concerns itself not so much with providing income for dependents as it does with providing a guarantee that a savings program, once inaugurated, will not be interrupted by death. The endowment contract provides that if death intervenes before the program is completed, whatever amount is lacking will be made up by the insurance. Therefore, wherever a need exists for a substantial fund at a particular time, the endowment policy has a very real use.

An endowment sold purely for the purpose of protection carries with it a premium entirely out of line with other less costly policies whose major function is protection. The situation is particularly serious if the resources of the insured for insurance premiums are limited and the need for protection is great. Finally, an endowment insurance policy, if purchased for protection, may defeat its purpose if the insured purchases the policy when young and the term is such that the contract matures when the policyholder has a maximum need for protection with little or no immediate need for a large sum of money. There is always the danger that the policyholder will lose the amount of the insurance money in some unwise business venture or through speculation. At the same time, he will have reached an age when insurance protection is high, and it may be that because he is no longer insurable insurance protection is out of the question at any price. This being the case, insurance underwriters point out the advantage of long-term endowments as compared with those offered by short-term endowments. Particularly attractive are endowments maturing at the ages of sixty or sixty-five. Such policies provide insurance protection for dependents until the insured himself is reaching an age when he will probably retire. The matured endowment

may then, through the use of the settlement options of the policy, be used to provide an income for the policyholder himself. As in all forms of insurance, short-term endowments and long-term endowments render their maximum service when adapted to the purposes for which they have been designed.

Life-Income Endowment Policies. Life-income endowment insurance provides for the insured the same protection that income policies already noted afford the beneficiary. A certain monthly income is provided, the income to begin at an age selected by the insured when the policy is written. The age which the insured may select as the point at which he wishes the income to begin varies from fifty to seventy. Obviously, the premium charge varies with the age of the applicant and the age at which the policy matures.

Policies of this class guarantee a certain income for a definite number of months. Thus, a policy with a principal amount might guarantee to pay at the age of sixty-five the sum of $10 a month for each $1,000 of insurance for a period of 100 months, and for as many months thereafter as the insured shall live. Under the terms of such a contract, if the insured dies after the age of sixty-five but before payment has been made for 100 months, payments will be continued to a beneficiary until the full 100 payments have been made. If the insured dies before the installment payments become due, the face amount of the policy is payable to the beneficiary in a lump sum.

This policy may be written on a limited-payment plan if desired. Under such a plan, premiums are paid an agreed number of years from the date of issue of the policy. No further payments are due thereafter, but the income feature does not become operative until the age indicated in the policy. A man at the age of twenty-five might purchase a life-income endowment policy payable at the age of sixty-five on a twenty-payment basis. After forty-five he would make no more payments, but income would not begin until he reached the age of sixty-five.

This policy is attractive to teachers, salaried employers, clergymen, nurses, and professional men who realize that old age will bring with it a lessening of earning power if, indeed, it does not make retirement imperative. When it seems necessary to make provision for the declining years, this policy is admirably adapted to meet the need.

Deferred Endowment Policies. Under this form the insured pays

the premium for a term, and the amount of insurance is paid to a designated beneficiary when the policy matures. If the insured dies during the term, premiums cease, but the insurance is not paid to the beneficiary until the end of the endowment period.

Policies of this type are frequently sold to provide funds to meet the educational needs of a child. The policy is issued on the life of a parent. The proceeds of the policy are payable to the child when he has attained a designated age. Policies are written to mature at the age, usually eighteen, when the child will need funds for college.

Some parents prefer to have payments made on an installment basis. When this is desired it can be arranged to have a designated sum paid once a year for four years, or it can be made payable semi-anually, quarterly, or monthly for the designated period.

Joint Life Policies. Under this form two lives may be insured in favor of each other under a single contract. It is, in fact, possible to insure more than two persons under a joint life contract, but such contracts involve complications that make them unattractive to insurance companies in the case of the withdrawal of one of the parties, and they are, therefore, rarely written to include more lives than two.

A joint life policy may be written on an ordinary life, a limited-payment, or an endowment form. Under the ordinary life or limited-payment form the amount of the insurance is paid to the survivor upon the death of one insured. The policy then is extinguished, and no insurance remains in effect on the life of the survivor. Under the endowment form the conditions are the same except that if both insureds are living at the end of the endowment period, the amount of the insurance is then payable to them.

This policy is attractive for partnership insurance because it is less expensive than two separate policies. This is so because, although payment is made if one of two persons dies, payment is made only upon the death of the first and is therefore made but once, and the policy is extinguished. Under two policies, payment would ultimately be paid under each. Because the intent of partnership insurance is to secure to the survivor a sum sufficient to pay for the deceased partner's interest in the business and because the purpose is accomplished when payment is made upon the death of one partner, the less expensive form of a joint policy is attractive when the premiums are paid out of the firm's earnings.

Family Income Form. This is a combination of ordinary life and term insurance in a single contract. The contract provides that if the insured dies within an agreed period from the date of the policy, an income will be paid the beneficiary for the balance of the term and then he will be paid the face amount of the policies. A policy, for example, may be written to provide the income feature if the insured dies within ten, fifteen, or twenty years from the date of the policy. If the insured outlives the period indicated, the beneficiary secures the face amount of the insurance immediately upon the insured's death.

This policy finds its use in protecting a wife and children. A young man with wife and small children, realizing that the proceeds of his insurance might soon be exhausted in caring for and educating his children, provides his wife with an income during the period that the children are dependent. The term of the income is so arranged that when the children become self-supporting the income terminates and the face amount of the policy is paid to the wife.

Decreasing Face-Value Insurance. Accomplishing much the same result as the family income policy, forms are written covering the insured for a designated amount. When the insured reaches a certain age the face amount of the policy is reduced. The reduction continues at specified intervals until a second agreed amount is reached, which then constitutes the amount of insurance payable at death. This policy contains no income feature but provides protection in a greater amount for the insured during the years when there is presumably the greatest need of protection.

Industrial Insurance. A parliamentary committee investigating the insurance needs of the working classes in England about 1854 found that the necessity of paying premiums annually, or even in such shorter periods as were then allowed, made insurance for the poorer people virtually an impossibility.

To meet the requirements of wage earners, many of whom belonged to the industrial classes, insurance companies were asked to provide insurance scientifically sound, with premium payments adjusted to the needs of industrial workers. This was eventually worked out by making the ordinary insurance coverages available and so arranging premiums that they were covered by a small weekly payment. To facilitate matters further, the premiums were collected through the agency of a personal representative who called at the

home of the insured each week for the purpose. Insurance so written is termed "industrial insurance."

Industrial insurance was first written in the United States in 1875. That the form meets a decided need is demonstrated by the success it has attained. Most of the ordinary forms of life policies are available in this category. Policies, however, are usually written for small amounts, averaging less than $200, with weeekly premiums of from 5 to 15 cents.

Industrial insurance provides for a very real need, and the social value of the protection afforded to wage earners that must otherwise be without insurance is hardly subject to calculation. It must be remembered, however, that life insurance premiums are based upon the scientific mathematical calculation of mortality, to which is added the cost of carrying on the business in the form of loading. The mortality rate in this class is particularly high because of hazardous occupation, unsanitary surroundings, insufficient food, inadequate medical attention, and exposure. Finally, the method of collecting the premium and the expense of handling small sums add materially to the cost item. The operation of these factors causes the rate for industrial insurance to be substantially higher than for ordinary insurance. For the classes of risk for which industrial insurance is designed, the policies are admirably suited and furnish sound and excellent protection. However, for the insured who can pay his premiums on a basis contemplated by the usual insurance rate, industrial insurance forms are expensive and hardly satisfactory.

Industrial life insurance has been severely criticized primarily because of its cost. It has been contended that industrial insurance designed to make insurance available for the low-income groups has the effect of offering protection to them at a rate that seems prohibitive. There is only one answer to this criticism, and this is to be found in the nature of the business. That the premiums charged for the same amount of protection are higher under the industrial form than are charged under the ordinary life form is true. A major element of expense is found in the tremendous amount of detail work required to service great numbers of small policies. In addition to the home-office detail, the small amount of each collection and the expense of weekly visits of the agent to the home of the insured to collect the premium must, of necessity, require an increased premium. In addition to this, industrial insurance is ordinarily sold

without the requirement of a medical examination, to the end that the insurance company does not secure the benefit of selection which a medical examination affords.

Attempts have been made within the business as well as outside of it to provide low-cost insurance in small amounts for poor people. The industrial policies offered have been enormously broadened in the last few years but still remain costly when the rates are compared with ordinary life rates. Alternative suggestions, such as the savings-bank life insurance plan inaugurated in Massachusetts and recently established in New York and Connecticut, have been offered to provide small amounts of insurance at low cost. The plans have provided an admirable form of insurance protection but are lacking in that, since they have no agency force, they have no means of stimulating the purchase of insurance, other than by general advertising, posters in banks, and the recommendations of bank officers and insureds. The stimulus of the agent's commission is lacking.

Industrial companies are frank in acknowledging that industrial insurance is unquestionably more expensive than the same amount of coverage under an ordinary policy form. To this end they are insistent that the individual in a position to take out ordinary insurance, whose health and occupation permit the use of standard rates, should apply for the ordinary form of policy so as to benefit by the savings in expense as well as to have the advantage of being placed in a lower mortality class than can be secured through industrial insurance. Unquestionably, persons who can qualify for the more complete and less expensive coverages under ordinary life insurance are building up for themselves needless costs if they buy industrial insurance. Industrial policies are designed to meet a particular need, and the companies selling industrial insurance are exerting every effort to give full value in the form of protection and service to the classes for which industrial policies are designed.

A second criticism of industrial insurance has been the high ratio of lapses. This criticism has been leveled at all life insurance but pointed with particular emphasis at the industrial field. In the early days, all industrial insurance policies were written without nonforfeiture provisions, and lapses resulted in heavy losses to the policyholder. In the report of the Armstrong Committee to the New York Legislature in 1906 it was brought out that about 34 per cent of

industrial policies were canceled in the first year and about 58 per cent in three years. The losses growing out of lapses were a source of criticism. Industrial insurance companies have since liberalized their policies to the extent that now there are valuable privileges available to the insured if he decides to discontinue his policy; on the other hand, the revival of lapsed insurance has been made relatively easy. In the face of these improvements, however, the problem of lapses continues to be one of concern to the insurance business. Because of the initial cost to the companies of new business, lapses are not a source of profit but, on the contrary, result in actual loss. They are a source of waste, because the losses must be made good from the premiums of persistent policyholders.

It is now believed that lapses, particularly if they occur in the early months of the policy, are due largely to the fact that the insured was oversold or not sold the proper form of coverage. Sales campaigns to produce new business and the striving to reach a quota at any cost has in many instances resulted in placing business on the books of insurance companies that ought never to have been there. Insurance companies recognize that it is their problem to correct the high lapse rate and are taking active steps in this direction. Insurance agents are being trained to analyze the needs of the prospect, and insurance companies are emphasizing to their representatives the antagonism that they generate when they oversell a prospect. It is also emphasized to the agent that, entirely aside from the possible embittering of the prospect against life insurance, it is to the agent's financial advantage to write business that remains on the books so that he may derive the advantage of renewal commissions. It is now definitely the policy of insurance companies to sell only insurance that good judgment indicates the prospective policyholder needs. That agents still oversell cannot be denied, but the practice is not regarded as good business in the insurance field.

To the importance of industrial life insurance in our economic structure millions of people in the United States bear witness. While the face of the industrial policy is small, it is impossible to estimate the effectiveness of the steady flow of funds from the great financial institutions handling the business to a wide group of people, mostly in the wage-earning group at a time, probably, when the need is very great. The trend toward liberalization of policy contracts set in

many years ago. As experience, prompted by competition, permits, the companies themselves have extended the benefits available under their contracts. In 1941, the Executive Committee of the National Association of Insurance Commissioners delegated to its Committee on Life Insurance the task of preparing a study of industrial insurance. This committee found that, while numerous states had taken effective steps in the direction of legislation controlling industrial life insurance, the legislation was by no means uniform. A uniform industrial standard provisions bill was prepared by the committee and approved by the commissioners at their December, 1943, meeting. This they have recommended as a model for use in those states where regulatory legislation is still lacking. The bill would make mandatory the use of certain standard provisions but would allow the substitution of others if they were more favorable to the policyholders. It is an interesting commentary on industrial life insurance that the industrial policies sold by the leaders in the field contain in many instances provisions considerably more liberal than those suggested by the Insurance Commissioners' subcommittee.[2]

Coverage for the Armed Services. It has already been noticed that mortality tables do not include assumption for such losses as may be the outgrowth of military service.[3] To take care of this risk in World War 1, under an act of Congress approved October 6, 1917, members of the military forces of the United States, in addition to other privileges, were given the right to take out insurance with the government. The act made provision for two widely different classes of insurance: (*a*) automatic insurance, and (*b*) contract insurance. "Automatic insurance" provided protection without application for a period prior to the time that contract insurance was available and for a period following up to February 12, 1918. This temporary coverage was designed to give the serviceman an opportunity to apply for contract insurance.[4] Contract insurance permitted him to apply to the government for a policy in amounts from $1,000 to $10,000 in

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[2] It is estimated that about three-fourths of the industrial insurance written in the United States is placed with the three largest companies in the field: the Metropolitan Life Insurance Company, the Prudential Life Insurance Company of America, and the John Hancock Mutual Life Insurance Company.

[3] See p. 726.

[4] Automatic insurance was in the nature of an arbitrary grant and resembles war risk term insurance only in that it is payable in 240 monthly installments. The monthly payments are always to the amount of $25.

multiples of 500. "Contract insurance" represents the permanent life insurance business written by the government for servicemen during the first World War. The first policies issued were on a convertible term plan and made available a maximum of $10,000 insurance at a low cost. The total of this insurance in force reached a maximum of $40,000,000,000 but with the termination of hostilities much of the insurance carried during the period of the emergency was allowed to lapse.

At the outbreak of the second World War, under the National Service Life Insurance Act, approved October 8, 1940, insurance, very similar to that provided for servicemen in the first World War, was made available. Policies were issued only upon the application of the veteran and required that the application be made 120 days after enactment of the law or entrance into service; otherwise, if the application were made later, the law required proof of insurability. A five-year term policy is written first; and this is convertible, prior to expiration, to an ordinary twenty-payment or thirty-payment life form. On December 20, 1941, Congress approved an act providing $5,000 coverage for death in line of duty prior to having made application for life insurance. This was to protect those who had not had an opportunity to make application for insurance prior to their death, and the coverage extended only to those in active service after October 8, 1940, and for a period of 120 days after the amendment, or until April 19, 1942. This was very similar to the automatic insurance provided during the first World War. At the termination of hostilities the Veterans' Bureau reports that $128,000,000,000 face amount of insurance was written for 16,694,000 applicants. This insurance, while not so broad in many respects as the policies available from life insurance companies, is valuable to the policyholder in that the cost for insurance is most favorable to the insured; and in many instances insureds, because of disabilities, might be able to obtain insurance from no other source. The life insurance business urgently advises veterans to maintain such government life insurance as they may have.

The War Shipping Administration was authorized February 2, 1942, by Executive Order of the President, to insure the lives of masters, officers, and crews of vessels against loss of life, personal injury, or detention by an enemy following capture, and considerable volume of such insurance was written during World War II.

FOR REVIEW

1. It is stated that life insurance is, in fact, sometimes property insurance. How can this be?
2. B left his estate in trust for his widow, who is to enjoy the income for life. Upon her death the principal of the estate is to be divided equally between the surviving children. B, a son, twenty-one years old, wishes to enter business and use his interest in his father's estate as security for a loan. The bank to which he makes application points out that his interest is a contingent one and that in the event he predeceases his mother his interest is extinguished. Suggest an insurance coverage.
3. What are the basic distinctions which differentiate industrial insurance from the other forms of life insurance?
4. Since the twenty- or thirty-payment life policy costs more than whole life policy, how can an insurance salesman be justified in offering any but the whole-life policy to a prospect?
5. A and B are partners in a business enterprise. A is the active member and as a result of years of experience has built up substantial goodwill. B is inactive and has never been identified with the business in the minds of the public. B's activity has been limited to financing the enterprise. It has been contended that the goodwill created by A's activity is an intangible asset not susceptible to measurement in terms of dollars and cents, and, therefore, in the event that a partnership policy is written on the life of A, its face should be limited to the actual monetary investment made by A in the business. Justify or criticize this statement.
6. When the Lord Baltimore Hotel in Baltimore, Maryland, was financed in 1927, a hotel man of experience was selected as president and manager. First mortgage bonds of $3,200,000 were issued against the property itself; 7 per cent cumulative first preferred stock amounting to $1,150,000 was sold to the public at par, and in addition 20,000 shares of common stock were issued without par. Life insurance was a factor in the financing. Outline a life insurance plan for this situation.
7. B, a life insurance salesman, states that he needs to sell a policy of $10,000 within the current month to meet a quota. As an inducement to sell the policy to you, he offers to remit his entire commission. What is your position, and what is the position of the agent?
8. B recently graduated from college and has entered upon the practice of law. He has a wife and child and is at the present time earning approximately $3,000 annually. He is able to save, above his living expenses, $500 annually. He contemplates buying a home but has been advised that he should expend the major part of the amount he is able to save upon life insurance. How would you react to this situation?
9. Endowment insurance is said to be a combination of two forms of insurance coverage. Can you explain what is meant by this statement?
10. It is sometimes stated that the ordinary life policy is in fact an endowment policy. What is meant by this statement?

11. X has inherited from his father $200,000 which he has been able to keep invested to yield 5 per cent. In addition to this, from his professional services he earns $5,000. In view of the size of his estate he feels that he has no need of life insurance, contending that his income from personal services is devoted primarily to his own needs and that the income from his investments is entirely adequate to meet the needs of his family in the event of his death. What is your opinion?
12. D is a young man, aged twenty-four, earning an exceptionally good salary. He is unmarried and has no dependents. All the members of his immediate family being in comfortable financial circumstances, D contends that he has no need of life insurance and that he can well afford to lose all the money he earns over and above his immediate requirements for living, which are modest. It is his intention, accordingly, to speculate for a period of at least ten years. Is this program a wise one?
13. X is thirty-nine years old, is married and has two children, aged nine and twelve. He feels that if he were assured of living until his children were grown up and educated, his life insurance needs would be limited to a sum of $25,000 to provide for his wife. On the other hand, should he die before his children are educated he feels the need of an additional sum to meet this contingency. He learns of a contract that provides for the payment of the face value upon death, but if death occurs at any time within ten years from date of issue double the face value will be paid. He makes inquiry of several companies, each of which states that it has no such policy. How could any insurance company duplicate the coverage X wishes to secure?
14. B has purchased a house valued at $10,000 and is paying for it under the monthly-payment plan of the Federal Housing Administration insured mortgage. The monthly payment covers principal, interest, taxes, and hazard insurance, as well as the mortgage insurance premium payable to the Federal Housing Administration. What additional step might B reasonably take to strengthen his position? Assume B to be twenty-five years of age and his loan to be for $8,000.

CHAPTER XXXVI

POLICY CONDITIONS

STANDARD Provisions. All policies of life insurance newly issued must include the standard provisions prescribed by the statutes of the jurisdiction, and new forms of policies are issued only when approved by the state insurance department. New York has taken a position of leadership in the field and has written into its statutes legislation providing adequate safeguards for the rights of policyholders.[1]

Through the activities of committees appointed by the National Convention of Insurance Commissioners, as well as the work of such groups as the Committee on Insurance Law of the American Bar Association and the National Conference of Commissioners on Uniform State Laws, most of the important laws governing the business of life insurance are to be found in the statutes of all jurisdictions. In addition to fostering uniformity of insurance legislation, the National Convention of Insurance Commissioners has been the outstanding agency for effecting a uniformity of statutory interpretation and of administrative rulings.

The trend of life insurance legislation has been in the direction of greater liberality in the terms of the contract in favor of the insured, at the same time so providing for the regulation of the business that it be conducted on a scientific and safe basis. Though the laws in all the states are not identical, over three-fourths of the legal reserve life insurance companies of the United States, of which there are about

[1] The New York law on life and endowment insurance, industrial insurance excepted, provides: (1) that there shall be a grace period of either thirty days or one month; (2) that the policy shall be incontestable after it has been in force during the lifetime of the insured for a period of two years from the date of issue; (3) that the policy shall constitute the entire contract between the parties; (4) that if the age of the insured has been misstated the amount payable under the policy shall be such as the premium would have purchased at the correct age; (5) that there shall be annual participation; (6) that options shall be specified to which the policyholder is entitled in the event of default of premium after the payment of three annual premiums; (7) that loan values shall be stated; (8) that there shall be a table showing in figures loan values and the options available under the policy in default of premium payments each year during at least the first twenty years of the policy; (9) that in the case of a policy payable in installments or annuity, a table shall show the amount of installments or annuity payments; (10) that reinstatement shall be covered. The foregoing provisions became effective on and after the first of January, 1910.

350, are licensed to write insurance beyond the borders of their home states. This has effected a substantial degree of uniformity in the life insurance contracts offered by the important legal reserve companies.

Insuring Clause. This is the first clause in the policy and names the company, the insured, and the beneficiary. As usually written, the clause states that the company agrees to pay a stipulated sum to the beneficiary immediately upon receipt of the proof of death of the insured or, in the case of an endowment, upon maturity.

If there are any special features in the contract, such as the payment of a double indemnity if death results from accident, or benefits in the event of disability, the company's obligations are set forth, subject to the policy conditions.

Next appears a statement of the amount of the premium and when it is payable. The clause provides that the contract is made in consideration of a designated premium payable in advance and payment of a like sum at designated intervals during the life of the insured, or for a stipulated period. The effective date of the policy is then stated.

Finally, it is stated that all the benefits and provisions printed or written by the company on the various pages of the policy are a part of the contract as fully as if recited at length over the signatures attached by the company officers, which appear at the end of the clause.

Dividends. If the contract is a participating one, a section of the policy covers the distribution of divisible surplus. The proportion of such surplus as accrues to the policy must usually be ascertained annually. Several options as to its uses are available to the insured.

First of all, he may receive the dividend in the form of a cash payment; or, what amounts to virtually the same thing, if premiums are being paid, the dividend may be applied toward the payment of the premium. If neither of these options is exercised, the dividend may be applied to the purchase of a participating paid-up addition to the sum insured. Exercise of this option means that the amount of insurance due the beneficiary upon the death of the insured will constantly increase with each dividend addition and upon maturity of the policy the amount due will be in excess of the face of the policy.

A fourth option, which is attractive to many, permits the insured to allow the dividends to accumulate at such a rate of interest as the company may declare on funds so held. Under this option, a guaranteed minimum rate is designated, but earnings are generally in excess of this amount. Such accumulated dividends are known as "dividend

deposits" and may be withdrawn in cash by the insured on any anniversary of the policy. If not so withdrawn, the accumulated dividends are payable at the maturity of the policy to the beneficiary or to any other person entitled to its proceeds.

In connection with the accumulation of dividends, some policies contain a provision that dividends may be applied to decrease the number of premium payments or mature the policy as an endowment. Under the terms of such a provision, whenever the cash value of the policy, including the cash value of any dividend additions and dividend deposits, shall equal the net single premium at the attained age of the insured for a fully paid participating policy of the same kind and amount as the policy upon which the accumulations have accrued, the company upon the written request of the insured will endorse the policy as fully paid, and premium charges will be discontinued. If the cash value and dividend accumulations equal the face amount of the policy, the insured may surrender the policy as an endowment, in which case the company agrees to pay the face amount of the policy in cash.

Accumulative Nonparticipating Forms. Companies issuing nonparticipating policies do not have the inducement of an increasing face value through the application of dividends to buy additional paid-up insurance. To supply as nearly as possible the features of the participating policy, for a small additional premium charge an annual increase to the face value of the policy is provided under an accumulative form. As in the case of the participating policy, when the accumulated additions are sufficient, a paid-up policy may be issued. After the first year, the accumulated additions may be drawn in cash. If neither option is exercised, the additional insurance so purchased will be added to the face value of the policy and paid to the beneficiary upon the death of the insured.

In the case of endowments, the same end is accomplished through the payment of a small premium in addition to the regular rate. The face of the policy increases each year. Upon the death of the insured during the term, the total insurance accumulated to the time of death will be paid the beneficiary. At the end of the term, the total insurance is paid to the insured.

Policy Ownership. Some policies indicate a life owner. Policies naming a life owner offer the applicant the option of retaining control of the policy or of placing this control with another. A clause is

used providing that during the lifetime of the insured the right to receive all cash values, loans, and other benefits accruing under the policy and the right to exercise all options and privileges or to agree with the company on changes or amendments to the policy shall vest alone in the life owner.

Policies written on a form designating a life owner usually provide that if the designated beneficiary dies before the insured, the interest of such beneficiary shall vest in the life owner. This condition is subject to modification, however, and a provision may be made for the vesting of the beneficiary's interests otherwise, if desired.

Change of Beneficiary. The right to change the beneficiary under a life contract has been held by the courts to be a property right of the insured. It is held that the company has no discretion in refusing to consent to a change upon compliance by the insured with the policy terms. When a substitution is to be made, however, the company itself may waive the policy terms, but if it does not elect to do so, it may require compliance.

Most policies provide a simple procedure to effect a change. It is usually stipulated that the beneficiary may be changed as often as desired by filing a written request therefor, accompanied by the policy, for endorsement at the home office of the company. Policies now provide that upon endorsement on the policy the change becomes effective as of the date of the request, thereby incorporating into the policy the established equitable doctrine that the insured, having taken all necessary steps to effect a change, should not have his intent frustrated by the failure of any of the formal acts of the company prior to his decease. The company inserts a saving clause, in which it is stated that the dating back of the time of the change of beneficiary to the date the insured signed the notice of change, whether or not the insured is living at the time of the endorsement, is without prejudice to the company on account of any payment made before the written request for the change reached the home office of the company.

If the policy is endorsed making the beneficiary irrevocable, the written consent of the beneficiary is required to make a change. Otherwise, consent of the beneficiary is not necessary, nor is it required that he be given notice of the change.

In the event the policy is not written indicating a life owner, the clause governing the change of beneficiary usually provides that if

any beneficiary dies before the insured the interest of such beneficiary shall vest in the insured, unless otherwise provided.

Payment of Premiums. Since premium payments are of vital importance to the validity of life insurance, the policy carefully states how and when premium payments are payable. Policies as now written require the payment of the first premium in advance, while the applicant is in good health. With the exception of industrial insurance, which is payable weekly, insurance premiums are computed on an annual basis, though they may be paid semiannually, quarterly, and in some cases, monthly. Premiums after the first, subject to a period of grace, are likewise payable in advance.

Premiums are required to be paid either at the home office of the company or to an agent authorized to receive payment. It is held that the ostensible scope of a soliciting agent's authority will extend to the collection of the first premium but of no other. It has likewise been held that the first premium payment may be made to an agent delivering the policy, regardless of policy stipulations regarding the receipt, but that the authority of the delivering agent to collect extends no further.

Obviously, since failure to pay the premium will seriously affect the position of the insured, it is essential to know what constitutes payment and to whom payment should be made. Policies cover the point by stipulating that all premiums are to be paid on or before their due date at the home office of the company or to an authorized agent of the company. When payment to an agent is authorized, it is usual to require that payments shall be so made only in exchange for the company's official premium receipt, signed by certain designated officers of the company and countersigned by the person receiving the premium.

Grace Period. It is the rule among life insurance companies to allow a grace period, usually of a month, in which due premiums may be paid. In some jurisdictions the grace period is provided for by statute, and where so provided it has been held that the terms "one month" and "thirty days" are not necessarily the same. It is common, therefore, to express the grace period as one month, but not less than thirty days. This period of grace is allowed for the payment of all premiums after the first. The policy is continued in force during this period; but if death occurs, the overdue premium is deducted from the face value of the policy when the claim is paid.

Reinstatement. Insurance companies are ordinarily willing to revive a lapsed policy and usually stipulate in the contract the conditions under which reinstatement will be made. Sometimes a time limit is set to the period within which reinstatement is permitted, and a medical examination may be required. All overdue premiums must be paid, together with interest thereon, from the due date at a stipulated rate.

If there is any other indebtedness to the company at the time of the default, this also must be paid or reinstated with interest in accordance with the loan provisions of the policy.

Change Privileges. Policies may contain a clause permitting the insured to change the contract to another form. A clause of this sort provides that at any time before default in the payment of a premium, provided the insured is less than fifty-five years of age, the insured may without medical re-examination exchange his policy for a policy upon any plan of insurance issued by the company having a higher rate of premium.

To effect a change from one form of contract to another, the contract to be changed must be surrendered to the company, and the difference in premiums, with compound interest at a designated rate, must be paid from the due date of each premium to the date of the exchange. The new policy then takes effect as of the date of the original policy, and the premium thereafter charged is at the rate which would have been charged in the policy had been originally issued on the new plan.

This option affords an applicant who is interested in one of the higher priced contracts, and at the same time uncertain as to his immediate ability to pay, an opportunity to secure insurance immediately on a lower-priced program, with time to work out for himself the form best suited to his needs.

Loan Value. One of the important features of life insurance is to be found in the loan privilege. When a policy has a surrender value, the guaranteed loan clause provides for advancement to the insured on the sole security of the policy any amount which, with interest, is within the limit of the cash surrender value.

The interest rate to be charged is usually designated in the policy, and interest payments are due on the anniversary date of the contract. Unpaid interest charges are added to the principal amount of the loan, and all or any part of the indebtedness may be repaid at any time

while the policy is in force. Failure to repay such indebtedness, or to pay interest, does not have the effect of voiding the policy, but whenever the total indebtedness accumulates to a point where it equals the cash surrender value of the policy, the policy becomes void after notice to the insured and assignee of record, if any. If the policy designates a life owner other than the insured, he also is entitled to such notice.

In the event of death of the insured before repayment of the loan, provision is made for payment of the face amount of the policy to the designated beneficiary, less the amount of the indebtedness, including accrued interest.

Nonforfeiting Values. In the field of life insurance a failure to pay premium requirements in accordance with the policy terms results in lapse of the insurance. It is the general rule that if a policy is allowed to lapse during the first three years, there is no return to the insured. Except for term insurance, the enactment of the nonforfeiture laws has made cash surrender values obligatory after the third year. A company may of its own option make a policy nonforfeitable prior to the third year, and some companies have set the period within which lapse results in forfeiture at two years.

Under the nonforfeiting provision of the contract there are three options open to an insured. These take the forms of: (1) cash value, (2) paid-up insurance, and (3) extended insurance.

If the insured elects to receive the cash surrender value, he surrenders the policy to the company, together with all claims thereunder, and is paid a sum in cash for which provision is made in the contract. Prior to 1943 the cash surrender value was based on the reserve on the face amount of the policy on the date of default, less an amount retained by the company, called a "surrender charge." In the early years of the policy the surrender charge may be as much as 2½ per cent of the face amount, but this gradually decreases until it ultimately disappears. If the policy is participating in form, the cash surrender value includes the reserve on outstanding dividend additions and outstanding dividend deposits.

After the annual meeting of the National Association of Insurance Commissioners, held in December, 1942, a change in direction was given to the matter of computing nonforfeiture benefits. A special committee appointed to study nonforfeiture benefits and related matters made a report which received the approval of the commis-

sioners. The committee recommended the adoption of a standard valuation law and a standard nonforfeiture law. It was recommended that, when the legislation was enacted in the various states to give legal status to the recommendation, the change be permissive after July 1, 1943, and mandatory not earlier than 1948. A number of states have already enacted the legislation, and it is under consideration in others. The new legislation provides an independent method of computing reserves and cash surrender values. Thus, as they appear in the newer policies, there is no continuing relationship between reserve and nonforfeiture benefits. The cash surrender values have been computed to recognize the same expense items that called for a heavy surrender charge during the early surrender-policy years. The fact, however, that the reserve and nonforfeiture values are separated, eliminates the appearance of a penalty in the event that the insured elects to terminate his insurance and collect his equity.

The second option provides for substitution of a paid-up life policy for the existing contract. It also provides that, within three months of the due date of an unpaid premium, the insured may surrender his policy and elect in its place to have the policy endorsed to continue as paid-up insurance in an amount which the cash surrender value at the date of default will purchase as a net single premium at the attained age of the insured at the date of the default. Such a contract continues insurance in effect, payable at the same time and under the same conditions as the original contract, but for a lesser amount of insurance. When this option is exercised, upon default, with an outstanding indebtedness against the policy, the amount of the indebtedness is subtracted from the reserve to determine the sum available for the purchase of paid-up insurance. If the original policy is participating, the policy continues to participate. The insured may borrow on the contract or surrender it for its cash surrender value.

The third option provides for continuation of the insurance as extended term insurance from the due date of the premium defaulted. It is provided that if any premium remains unpaid at the end of the days of grace and the policy has been in force for a specified period of time, usually three years, the insurance will automatically continue as from the due date of the premium in default as paid-up nonparticipating term insurance. The amount of the term insurance is the face amount of the policy. If the policy has been increased by any dividend additions or by any dividend deposits, this increase con-

tinues as an addition to the face of the policy under the paid-up term insurance option. Any indebtedness to the company is deducted from the face of the insurance. The term for which the policy continues in force is that term which the net cash value at the premium due date will purchase applied as a net single premium. If the insured fails to elect within three months the cash value or paid-up insurance option, the term insurance option automatically continues in effect. Anytime within three months after the date of a premium default, the insured may surrender the policy for its net cash value.

The paid-up option provides a smaller amount of insurance than the third, but it is for life. The third option continues as term insurance the full amount of the policy in force at the time of default for as long a period as the accumulated reserve will pay. In order to protect the insured, policies are generally written in such a way that, in the event the insured fails to indicate a choice of the options, extended term insurance becomes effective automatically upon failure to meet a premium payment.

Term Insurance in Case of Loan. Since the amount of any unpaid loan, plus accrued interest charges, is deducted from the sum paid to the beneficiary in the event the insured dies before the loan has been paid, insureds are frequently reluctant to take any step that will so diminish the proceeds of the insurance.

In order to make the loan privilege available to an insured without the risk of diminishing the amount payable to the beneficiary, the policy may provide for term insurance covering the amount of the loan. When so written, the amount covered by the term insurance is used to cancel the insured's indebtedness to the company in the event of death while the loan is still unpaid.

To provide protection of this kind covering a loan, the company may exact such evidence of insurability as it may require, and the premium is computed at the attained age of the insured at the time the term insurance is made or renewed. Such insurance is written from year to year, with an upper-age limit beyond which this insurance is not accepted.

Self-Destruction. Life policies cover the contingency of suicide by inserting a clause in the contract providing that if the insured shall die "by his or her own hand or act" during the first two insurance years, whether he be sane or insane, the insurance under the policy shall be only the amount of the premiums paid. After the two-

year period, death by suicide does not affect the amount of the insurance, the full face of the policy being payable to the beneficiary.

In the case of death occurring under such circumstances as to indicate suicide, there is no presumption that the death was the result of an act of self-destruction. If the insurance company denies liability on the ground of suicide, it must assume the burden of proof and establish its case. If the evidence is uncertain, there is a presumption in favor of the insured that death occurred as the result of an accident or from natural causes.

Incontestability. After the death of the insured, which may occur many years after the policy was issued, it would not always be easy for a beneficiary to justify statements made by the insured when the policy was issued. For this reason, a denial of liability by the company on the grounds of fraud could protract settlements and possibly deprive a beneficiary of his insurance.

To put an end to the possibility of involving the beneficiary in expensive litigation in effecting life insurance settlements, the companies now insert a clause in their policies providing that the policy shall be incontestable a certain period after the date of issue. Two years is the period frequently used, though some policies are incontestable after one year, and other companies have indicated three and five years as the period.

The period indicated in the incontestable clause begins to run from the date of issue of the policy. If the policy is reinstated or otherwise changed so as to require another medical examination, the period begins to run from the date of the reinstated or new policy.

It has been contended by some that, if it can be shown that the policy was procured by fraud, it may be voided at any time by the company. Courts have held, however, that if a stated period has been reserved in the policy within which the contract may be contested, fraud must be discovered within that time. A policy procured through the agency of fraud is not void but is voidable at the option of company. Under the incontestable clause the insurer is held to have abandoned voluntarily its option to void the contract at the end of the period allowed for contest.

Misrepresentation of Age. Since the annual premium on a policy written with a level premium is based upon the attained age at the inception of the policy, applicants have sometimes deliberately under-

stated their age. In other instances, the misstatement has been the outgrowth of a mistake.

Life policies contain a special clause covering the subject that is equitable to both the insured and the company. The clause provides that if the age of the insured has been misstated, the amount payable under the policy shall be such as the premium paid would have purchased at the correct age.

Since age misrepresentation is covered by a special clause, it cannot fall within the scope of the incontestable clause. Age discrepancies are most frequently discovered when proofs of death are being filed. Regardless of the time of discovery, the amount due under the policy is adjusted to coincide with the amount the premium would have purchased had the age been correctly stated.

The Application. As a basis for accepting or rejecting an applicant for insurance, the companies writing life insurance require certain information. One of the important sources of information is a form termed an "application." The application is divided into two parts, the first to be filled out by the soliciting agent and the second, by the examining physician.

The first part of the application calls for the name, residence, age, and occupation of the applicant. Former residences and occupations are then required. The plan of insurance applied for, when premiums are to be paid, beneficiary, other insurance in force, all must be stated. The second part of the application covers the family record as to longevity and evidence of the physical fitness of the applicant.

In some jurisdictions the statutes require that the insured be furnished with the entire contract. Policies now make the application a part of the contract, and a photostatic copy is attached. When so written, the policy ordinarily provides that no statement shall void the policy or be used in defense of a claim under it, unless it is contained in the written application and a copy of the application is endorsed or attached to the policy when issued.

Optional Methods of Settlement. If a policy provides for a lump sum settlement, it has become an established practice in the life insurance business to insert a clause giving the insured the right to have the insurance made payable in installments. In case the insured during his lifetime does not elect to have the proceeds of the insurance paid under one of the optional plans instead of as a lump sum, the

beneficiary himself upon written notice to the company may take advantage of the options offered. The different modes provided in the policy for settlement other than by the payment of a lump sum are termed "settlement options." Settlement options are not the same in all policies. Several of the more usual follow.

First Option.—The proceeds of the insurance, in whole or in part, may be left with the company, subject to withdrawal at any time on demand, in sums not less than $100. The company agrees to credit interest annually on the proceeds so left, at such rate as it may declare on such funds, but guaranteeing that the rate will not be less than a rate indicated in the policy. At the death of the payee, any unpaid sum left with the company is paid in one sum to the executors or administrators of the payee, unless otherwise agreed in writing.

Second Option.—The proceeds, or any part thereof, may be left with the company at interest until the death of the payee. The company agrees to distribute the interest on the amount annually, semiannually, quarterly, or monthly, as may be agreed upon. The rate, as before, is that paid by the company on such funds, with a minimum guarantee. Upon the death of the beneficiary the principal amount of the insurance, plus any unpaid interest, is paid either to the estate of the beneficiary or to another beneficiary, depending upon the terms of the agreement.

Third Option.—As much of the insurance fund as seems desirable may be left with the company at interest and be paid in equal annual, semiannual, quarterly, or monthly installments of such amount as may be agreed upon, until the entire proceeds, including interest, have been paid. In the event of the death of the beneficiary before the entire fund has been paid, the balance is disposed of as in the case of previous options.

Fourth Option.—Under this option, instead of paying the beneficiary a fixed amount as long as the money lasts, the beneficiary receives amounts as large as the face amount of the insurance will warrant in installments for a guaranteed number of years. The number of years of payment may be from two through twenty, and the payments may be made annually, semiannually, quarterly, or monthly. In the event of the death of the beneficiary before all payments have been made, payments may be continued to a second beneficiary, or a lump sum payment made to the beneficiary's estate in an amount equal to the present value of the unpaid guaranteed installments.

Fifth Option.—The conditions of this option are the same as the foregoing, with the further provision that if the beneficiary shall outlive the period of guaranteed payments, the payments will be continued so long as the beneficiary shall live. In the event of the death of the beneficiary before all guaranteed payments have been made, the unpaid installments are payable as under the previous option.

The optional methods of settlement are available as policies are now written, whether the proceeds are payable as a death claim, or upon maturity as an endowment, or upon surrender of the policy for its cash value. The trend in recent years has been in the direction of making increasing use of settlement options. They assume an important place in determining the type of insurance to be purchased when the insurance program is being set up. Here again the life insurance program is frequently correlated with social security benefits.

The decreasing return from investments that has made its impact felt wherever life insurance yields are a consideration has resulted in a tendency, in the case of the newer policies that are written, to reduce guaranteed interest rates under settlement options. The very fact that money is so difficult to invest in safe securities at anything but extremely low yields has prompted beneficiaries to take advantage of optional settlement plans. This is particularly true in the case of older policies where the settlement options provide relatively higher yields than may be obtained from any other source from conservatively invested funds.

Disability Provision. Upon the payment of a small additional premium, a disability feature may be incorporated in the life policy. Under its terms, if before the anniversary date of the policy nearest the sixtieth birthday of the insured the latter becomes totally disabled by bodily injuries or disease, the payment of premiums falling due from the commencement of and during the period of such disability is waived.

Total disability under such a clause requires that the insured be so disabled as to be prevented from "performing any work or conducting any business for compensation or profit." The clause provides, however, that if the insured meets with the irrecoverable loss of the entire sight of both eyes or the total and permanent loss of use of both hands, of both feet, or of one hand and one foot, such loss is to be considered total disability.

Premiums waived on account of this clause are not deducted from

settlements made under the policy. The benefits and values, such as the sum insured, the loan and cash surrender values, and, in the case of participating policies, the dividends—all remain the same as if the premiums had actually been paid in cash.

Some policies provide for monthly indemnity payable in case of total disability. The types of disability coverage under outstanding forms vary widely. The more recent tendency has been to restrict the scope of disability coverage under life insurance policies, and some companies have discontinued writing this form of coverage.

Annuity benefits for disability were introduced in the life insurance field in 1916. The early policies provided an annual income of $100 for each $1,000 of insurance, paid during total disability in addition to premium waiver without impairing the face amount of the policy. The benefit was soon changed to $10 monthly. Various changes in the contract were offered from time to time, and one company provided policies increasing the income 50 per cent after five years of disability and doubling it after ten years.

In the early years, disability benefits were offered by only a few companies; but by 1925, of 50 of the principal companies in the United States, only one did not offer disability benefits. Of 245 American companies, all but 6 issued some form of disability benefits with their life insurance policies. The period following 1925 was one of keen competition and disability business expanded rapidly. Policy provisions were liberalized, and the attitude toward claims became increasingly lax. The results were far from satisfactory, and the disability business of many of the leading companies brought claims far in excess of estimated revenue. The period of depression that followed World War I brought with it economic pressure and want. As a consequence, dishonest claimants found in the disability clause of life insurance a source of income. This phase of the life insurance business found itself facing grave difficulty and fast passed into disrepute.

Drastic reorganization was effected in the period following 1932. Some companies withdrew from the disability business altogether. Other companies reduced their benefits and accompanied this reduction by an increase in rates. The most usual practice found generally acceptable was the abandonment of the monthly disability benefit and the retention of a waiver of premium coverage. Generally speaking, benefits were sharply curtailed, and premiums for such coverage

as granted were advanced. Stricter underwriting requirements were adopted, but even with these changes only a few companies continued to offer the monthly disability coverage. When a monthly income benefit is provided, the more usual practice is to pay to the insured an amount equal to $5.00 for each $1,000 of insurance carried, upon receipt of proof that the insured is totally and presumably permanently disabled before the age of fifty-five. Income benefits are not written in connection with term insurance policies, nor do they apply in the case of paid-up insurance provided under the nonforfeiture values of the contract. When the insured reaches the age of fifty-five and the income disability feature of the policy no longer applies, future premiums on the policy are reduced by the amount of the annual charge for the disability benefits.

Double Indemnity. A feature of life insurance that is becoming increasingly popular is the provision for payment of a double indemnity in the event that death is caused by accident. On the basis of the needs of the beneficiary, it is hard to justify a greater payment if the insured dies as the result of an automobile collision than if he dies of pneumonia. The fact remains, however, that this feature of life insurance is attractive to insureds and widely used.

The clause in the policy provides that if death occurs before default in payment of premium and before the anniversary date of the policy following the insured's sixty-fifth birthday and if such death "results directly and independently of all other causes from bodily injuries effected solely through external, violent and accidental means and occurs within ninety days from the date of such accident, and if such injuries are evidenced by a visible contusion or wound on the exterior of the body (except in case of drowning and internal injuries revealed by an autopsy), and if such death does not result from suicide while sane or insane, from military or naval service in time of war, from an aeronautic flight or submarine descent, from the taking of poison or the inhaling of gas whether voluntary or otherwise, nor directly or indirectly from disease in any form," the double indemnity is payable.

The double indemnity benefit is incorporated in the life insurance policy upon the payment of an additional premium, and the benefit is not included in the paid-up insurance or extended term insurance granted in the event of a default in the payment of premium. The double indemnity feature of a life insurance policy may be dis-

continued upon written request of the insured, and the premium charged therefor discontinued.

FOR REVIEW

1. X insures his life for the benefit of B and later borrows on his policy from the insurance company. X dies, and B contends that he is entitled to the full face of the policy and that the insurance company should collect the loan from the estate of X. Is B correct?
2. X is the beneficiary of Y. His policy is written for a face of $10,000 with a double-indemnity feature for accidental death. He is found dead under circumstances that might be termed either suicide or accidental death, due to the inhalation of gas. Is it a matter of concern to the beneficiary, from the standpoint of insurance payments, to establish that the death was not a suicide?
3. A is found dead two months after the purchase of a life insurance policy, under such circumstances as to suggest suicide. Financial embarrassment of the deceased lends probability to the suicide theory. The policy excludes coverage for suicide within one year from its date. What is the responsibility of the company and of the beneficiary with reference to protecting their interests?
4. What is the suicide clause? In your opinion, should the usual period of two years be lengthened or shortened?
5. X secures a life insurance policy which excludes the risk of suicide for two years, but states the policy to be incontestable after one year. X commits suicide after eighteen months, and the company denies liability. The beneficiary files a claim on the ground that the policy is incontestable. Are the clauses contradictory?
6. The policy of X is incontestable after two years except for nonpayment of premium. X dies at the end of twenty-three months. An executor is not appointed for sixty days. The company indicates its intention to contest the claim, but the executor contends that the period within which contest may be started had expired at the time of his appointment. What is your opinion?
7. B has a brother C who is suffering from tuberculosis. B presents himself at the office of X Insurance Company and applies for a policy, giving his name as C. The policy is issued, and three years later C dies. The incontestable period in the policy is two years. C's children are named as beneficiaries and are entirely innocent of the circumstances surrounding the issuance of the policy and, in fact, knew nothing of its existence until after C's death. The insurance company, learning of the long-standing case of tuberculosis, refuse to pay, but the attorneys for C's estate contend the policy to be incontestable. What is your opinion?
8. A is twenty-eight years old. In applying for a whole-life policy he gives his age as twenty-four. He advises a friend that it is absurd to give one's correct age in applying for life insurance because, by giving a younger

age, a lesser premium is obtained. The friend seeks advice concerning the action and is told that a deliberate misstatement of age with the intent to mislead constitutes fraud and the policy is void from the beginning. What is your opinion?

9. In the field of life insurance, reference is frequently made to the term, "nonforfeiting values." What is meant by this term?
10. If the wife of A is named as A's beneficiary under a $10,000 policy, compute the payments the beneficiary would receive if, instead of taking a lump sum settlement, she leaves the money with the company to be paid in five annual installments, assuming the company guarantees 3 per cent interest.
11. D wishes to provide his wife an income of $100 monthly for life in the event of his death. Since the bulk of his estate will be life insurance, he does not wish the proceeds of his insurance to be exhausted by the payments to his wife. How much insurance is necessary to provide the income for the wife and not deplete the amount of insurance to be paid to the chilidren? How is this accomplished?
12. The state statute where X resides requires life insurance companies to send a premium notice to all policyholders as well as a notice of intention to terminate a policy. B, a policyholder, in the course of negotiating a policy loan signed an agreement waiving his right to such a notice. He inadvertently allows the policy to lapse and wishes to reinstate it. The company is requiring another medical examination. In your opinion, may it do so?
13. The X Life Insurance Company, doing business in New York, wished to issue a policy containing an aviation exclusion rider. The Superintendent of Insurance disapproved of the rider on the ground that this limitation of liability for loss due to aviation was in conflict with the incontestable clause. What is your opinion?
14. B negotiates for a policy of insurance with the X Company on the life of M with the intent to murder M. At the end of three years he attempts to murder M by poisoning, but fails. May the insurance company terminate the policy? The heirs of M claim that the incontestable clause makes cancellation of the contract impossible. What is your opinion?
15. B carries a life insurance policy in the amount of $10,000 with a provision for double indemnity in the event of accidental death. The policy contains an exception eliminating the double indemnity feature in the event that the accidental death is the outgrowth of any mental infirmiy. B's death occurs under such circumstances as to leave doubt as to the company's liability. The beneficiary, however, claims that the incontestable clause makes payment by the company mandatory. May the company contest the claim?
16. M carried a life insurance policy for $10,000 with double indemnity for accidental death. The beneficiary, upon the death of the insured, brings suit for $20,000. Death occurred within one year, and the company denied liability on the ground of suicide. It could not be shown conclusively that there was suicide. so a verdict was awarded of $10,000. Explain how this was a proper verdict.

CHAPTER XXXVII

ANNUITIES

DEFINITION. An annuity, according to Lord Coke, "is a yearly payment of a certain sum of money granted to another in fee, for life or years, charging the person of the grantor only." With reference to the foregoing definition, the insurance historian Walford goes on to state:

An annuity may be receivable during a definite number of years in which it is termed an *annuity-certain.* The value of annuities of this kind depends only on the rate of int. for money and the number of years during which the annuity is payable. If the annuity be payable forever, it is called a *perpetual annuity* or a *perpetuity.* If for a limited number of years, a *term annuity.* If not till after a certain date, it is called a *deferred annuity.* If its payment be dependent on the happening or non-happening of some particular event it is called a *contingent annuity.* If the commencement or the continuance of the annuity is any way dependent upon the duration of any life or lives, it is called a LIFE ANNUITY. It is with these we have especially to deal in these pages.

A *life annuity* may partake of some of the incidents of an annuity certain. If the annuity be for the whole period of any particular life, it is called a *whole-termed annuity.* If it be on a given life for a certain number of years, it is called a *term annuity;* for a few years only a *short-term life annuity.* If the annuity be payable on any one life, provided another be then living, or providing some event happen or do not happen, it is a *contingent life annuity.* If it is not to be entered upon till after death of some person or persons previously living, it is called a *reversionary annuity.* When it is continued only for a term of years, provided an individual or individuals then living shall survive that term, it is called a *temporary life annuity.* When it is payable during the lives of several persons living at the same time, it is called a *joint-life annuity.* When to the survivor of several lives, then a *survivorship annuity.* There are also *increasing* and *decreasing* annuities. These may depend upon life or otherwise.

There is yet another definition. An annuity is *curtate* when it ceases with the last payment prior to the death of any specified life: *complete* when the payment is to be continued up to the day of the annuitant's death.[1]

An annuity is the reverse of a life insurance policy. Under a life policy in its simplest form, certain premiums are paid on an annual basis during the lifetime of the insured, and upon his death a lump

[1] Walford, C., *Insurance Cyclopaedia* (London: Charles & Edwin Layton, 1871). Vol. I, p. 98.

sum is paid a designated beneficiary. Under an annuity a lump sum is paid at the outset, and in consideration therefor an annual payment is made thereafter during the life of the annuitant.

The annual premium payment under a life policy is computed for the age of the insured with the mortality table as a basis. It has already been noted that premiums payable annually for a term or for life may, by discounting the interest factor, be reduced to a present value. Such a present value is the amount of the single premium for the coverage. Now, carrying the process one step further, if the single premium is an amount equivalent to an annual premium on a life policy for a term, or for life, it is a simple process to accept the amount of the single premium, and contract to return each year an amount equivalent to the annual premium. This is precisely how the basic charge for an annuity is computed.

The person designated to receive the payment under an annuity contract is termed the "annuitant." The annuity is the specific amount designated to be paid yearly to a designated person. The amount paid in a single sum, that is, the purchase price paid for the annuity contract, is the consideration for the annuity or the value of the annuity.

Annuities antedate by many centuries, so far as extant records are available, the contract of life insurance. In ancient Rome in the year 40 B.C., legislation gave rise to the necessity of valuing annuities, and the outgrowth of the law was the development by the Roman jurists of the first-known life annuity values graduated with reference to age. Loans in the Middle Ages and later were repaid in the form of annuities, and governments used life annuities as a means of raising money. The early mortality tables had for their use the determining of the values of life annuities. Lacking the development of mortality tables, life insurance upon a scientific basis would have been impossible. Life insurance as an offshoot of the annuity has far outgrown its parent in importance. Nevertheless, the business of writing annuities is handled by life insurance companies and is an important branch of the present-day life insurance business.

Uses of the Annuity. Periods of financial difficulty and distress have emphasized to those having money the wide range of hazards to which investments are exposed. The individual, even if possessed of great wealth, finds himself unable to secure a diversification sufficiently wide to prevent shrinkage, and the owner of a moderate for-

tune may find himself facing actual distress through defaulted interest on bonds or reduced or passed dividends on stocks. Finally, and most costly of all to the individual, some change in business trends may have the effect of making a sound and going concern of little value, if not worthless.

Even the shrewdest and most experienced investor cannot hope to avoid all investment losses. This is so because there are so many factors beyond the control of the investor. However, the situation becomes immeasurably aggravated when the funds, upon which dependence is placed for income, are in the hands of the inexperienced or the credulous for investment. The temptation to speculate is not easily resisted, and the lure of a high return catches the uninformed. Added to inexperience is the element of fraud. Estimates place the annual loss of funds through investments purchased in get-rich-quick schemes of unscrupulous promoters at about a billion dollars.

Again, the funds of widows, orphans, and the aged have been depleted by following the advice, well-meant and honestly given but nevertheless bad, of relatives or friends. There are, everywhere, individuals who have never had the administration or control of funds of their own and who spend many hours in daydreaming a fortune. In good faith these people are frequently most persistent with their advice to friends and relatives, and more often than not the advice is bad.

It is natural for youth to speculate. Losses in early life do not carry the serious train of consequences that similar losses entail in the declining years, when productive capacity has diminished or disappeared entirely. In the later years of life the safety of principal and the certainty of income are the first requisites of an investment program. The purchase of a life annuity with funds set aside for retirement income seems to solve the problem. The security of a sound life insurance company, fortified by legally prescribed supervision, relieves the annuitant of the uncertainties of management and investment.

Effects Lifetime Distribution of Capital. A second important function of the annuity is to apportion the capital of the annuitant so that it will last him throughout his life. It can readily be seen that a man sixty-five years old with $20,000 has somewhat of a problem to secure to himself the maximum benefits of the fund during his lifetime. Invested at 4 per cent, his income will amount to $800. If the

apportions a certain amount of his principal to be spent each year, he may reach a point where income and principal will be depleted and find himself dependent and in need. Even if this point is never reached, the knowledge of constantly decreasing resources, coupled with the knowledge that death must come before a certain time or else need will follow, is psychologically bad.

Where the bare income from capital is insufficient to meet its owner's needs, the investment of the capital in a life annuity will yield, particularly at advanced ages, a sum substantially in excess of the interest yield, and in addition, regardless of how long the annuitant lives, the income is paid for life. The annuitant, therefore, is freed from financial worry, and the confidence of an assured income for life leads to a serene and favorable mental attitude. It is contended that this freedom from financial worry tends to prolong the life of the annuitant and has given rise to the insurance adage, "Annuitants never die."

The Annuity Business. As has been noted, according to a technical definition an annuity provides for a yearly payment of a certain sum in money. There is no necessity for the payment of a consideration. Annuities frequently were, and still may be, presented in the form of a gift to the annuitant. When the obligation to pay the annuity is the outgrowth of a contract, a consideration is required. The consideration is the premium. In its simplest form it is payable in a lump sum, but installment premiums may also be arranged. As a branch of the life insurance business, numerous forms of the annuity contract have been developed. These have been designed as the outgrowth of experience to meet the needs of different life situations. The most widely used of the various forms offered by life insurance companies are presently to be noted.

Relation of Premium to Age and Sex. In computing the life insurance premium, it has been noted that in the case of the natural premium the amount of the premium increases with age. This has the effect of making the annual amount of a level premium increase with the increase of the attained age at the time the policy is written. Stated differently, the younger the insured when the policy is written, the lower the annual premium.

In the case of an annuity the reverse is true. The younger the annuitant, the greater must be the consideration for the annuity to pay a designated sum for life. Obviously $10,000 will purchase a greater

income for life for a man of seventy than it will for a man of twenty. Annuities have made a particular appeal to elderly people without dependents who are concerned with providing a maximum income for life on the basis of available resources.

It has already been pointed out that mortality tables, used as a basis for life insurance premiums, are conservative in that they provide a factor of safety for the insurance companies to the extent that mortality does not reach the expectations indicated in the table. It is at once apparent that if annuities were sold on the basis of the table that is conservative for life insurance the result would be disastrous. This is so because the annuity is the exact reverse of life insurance. If the mortality for life insurance overestimates the number of deaths a savings is made that is reflected in dividends. In the case of annuities, if the mortality table were to overestimate the number of deaths, this would reflect adversely upon the financial position of the company. This is so because the longer the annuitant lives the more funds that are necessary to make the payments agreed upon under the contract. For this reason a table designed for the purpose is used as a basis for computing annuity premiums.

In recent years it has been the experience of life insurance companies that annuitants are showing a progressively lower rate of mortality. As an outgrowth of this situation, an annuity table, designed to reflect current conditions, and known as the "1937 Standard Annuity Mortality Table," was announced in 1938.[2] It is used both for men and women; but since it has been the experience of life insurance companies that women outlive men, for the purpose of computing an annuity premium for a woman, an age five years younger than that used for men is selected from the table. To reflect a conservative policy, life insurance companies writing annuities usually base the charge for male annuitants at an age one year younger than the actual age of the annuitant. Since the computation for women is based upon an age five years younger than that for men, following the same procedure, the annuity for women is based upon the survival assumption for an age six years younger than the actual age.

On the basis of current earning levels, insurance companies are

[2] The following tables have been widely used for the purpose of computing annuity premiums: the McClintock Annuity Table, published in 1899; the American Annuitants' Mortality Table, published in 1940; and the Combined Annuity Mortality Table, published in 1928.

predicating their annuity contracts upon an assumed interest rate of 2 or, at the most, 2½ per cent.

Medical Examination. No medical examination is required for the purchase of the usual annuity. In the case of life insurance, the medical examination serves to forestall unfavorable selection through the insurance of an undue proportion of impaired risk. Since, in the case of an annuity, impairment can in no way adversely affect the interests of the insurance company, a medical examination can serve no purpose. When disability benefits are made a part of the policy, the contract ceases to become a straight annuity agreement and a medical examination is required. Medical examination is also required in the case of a survivorship annuity.

Annuities Classified by Term. The time between the beginning of the first payment interval and the end of the last payment interval represents the term of the annuity. On the basis of term, annuities are classified as "perpetual annuities," "annuities-certain," and "contingent annuities."

A perpetual annuity, or perpetuity, is created when the period of the stipulated payments continues indefinitely to the annuitant, his heirs, or other successors forever. Perpetuities represent a guaranteed income in the form of interest upon a capital sum but do not undertake to distribute capital together with interest over an agreed period. Certain securities of the debenture class without maturity date fall into the category of perpetuities. Among the best known of these are the "British consols," which are in fact government bonds without maturity date.

When an annuity is to be paid for a definite period of time, the annuity is an "annuity-certain." Such an annuity undertakes to pay a definite sum at agreed intervals until an agreed number of payments has been made, and the continuation of the payments is in no way contingent upon the life of the annuitant.

When the inauguration or the termination of the payments of an annuity is dependent upon the happening of some event, the annuity is said to be "contingent." When the annuity is payable during the entire life of an individual and terminates with his death, the annuity is termed a "whole-life annuity."

Annuity contracts are written involving various combinations of the features of the foregoing classes and are written contingent upon the survival of more than one life.

The Immediate Life Annuity. This contract provides for the inauguration of payments to the annuitant at the end of the first income payment period following the purchase of the annuity, with the provision that the payments shall continue throughout the life of the annuitant but terminate with his death, regardless of how soon that death shall occur. Payments are made to the annuitant annually, semi-annually, quarterly, or monthly. The premium on this contract must be paid in a lump sum as a single premium in advance. Under this type of contract there is no guarantee of a definite number of payments, no cash value, and no provision for refund of any sort upon the death of the annuitant.

Because of the reluctance of individuals to deposit substantial sums in the form of a single payment premium and relinquish the entire premium as earned in the event of early death, several modifications of this form are offered with varying refund provisions. The advantage of the form is to be found in the fact that under it, companies are enabled to make the largest annual payments and continue these payments for life.

The immediate life annuity appeals particularly to persons of advancing age without dependents and of limited means who wish to secure for their remaining days the maximum benefit from their accumulations. The contract is also used by more wealthy persons for the purchase of retirement income as a safety reserve against severe business or investment losses.

The Refund Life Annuity. This contract is much the same in its provisions as the immediate life annuity. The payment of a single cash premium secures for the annuitant an immediate annuity for the entire period of his life, payable annually, semiannually, quarterly, or monthly, as the annuitant may elect. The point of difference lies in the refund agreement, which provides that if the annuitant dies before the aggregate of payments equals the premium, payments will continue to a designated beneficiary until an amount equal to the full sum of the single premium has been returned.

Under the terms of this agreement the annuitant, or his designated beneficiary, is certain to receive in payments an amount equal to the premium payment without interest. The annuitant, on the other hand, may live long enough to withdraw from the company payments that will aggregate a sum substantially in excess of the premium. The annual payments under this form are somewhat less

than is the case under the immediate life contract. A modification of this form, permitting an increase in the amount of the payments to the annuitant, limits the refund guarantee to 50 per cent of the purchase price of the annuity. This contract is known as a "50 per cent refund life annuity."

This annuity is attractive to those who wish to be guaranteed a life income but, at the same time, wish to leave something in cash to those near them, or to provide a sum for a particular interest or charity.

Life Annuity with Number of Payments Guaranteed. This contract is not unlike the refund life annuity. It provides for regular payments to the annuitant at the agreed interval. The payments continue during the lite of the annuitant but, in any case, for a definite number of years. This contract operates to pay the annuitant as long as he may live, but the amount to be paid to a designated beneficiary is contingent, not upon the purchase price of the annuity, but rather on the number of years the annuity has already run. For example, if payment is guaranteed for twenty years and the annuitant dies at the end of five years, payment will be made for a period of fifteen years more to a designated beneficiary. If the annuitant, however, outlives the number of years guaranteed, payments will be made to him during his entire life, but nothing is paid to the beneficiary upon his death.

Joint Life and Survivorship. Frequently the need of an income involves more than one person. This is usually found when a man and wife without dependents wish to make provision for the old age of both. The contract provides an immediate annuity for the duration of more than one life. A contract widely used guarantees an income for two persons during the lifetime of both and, upon the death of one, continues without reduction until the death of the survivor. The contract may also be written involving more than two persons, and when so written the income is payable without reduction until the death of the last survivor of the group.

Under this type of agreement it is not usual to provide cash surrender or loan value. Likewise, no value or balance is available upon the death of the last annuitant for payment to a beneficiary. Occasionally policies of this type are written on the basis of a guaranteed number of payments certain. Under such a policy, the annuitants, or the survivor of the annuitants, receives the agreed income for life,

but if the number of payments made is less than the certain number agreed upon the balance is paid to a designated beneficiary.

Temporary Life Annuity. Under this contract, payment is made to the annuitant for a stipulated term of years, but payments terminate upon the death of the annuitant. Contracts are written providing for the return of any unpaid balance of the purchase price in the event of the death of the annuitant before the end of the term, or the contract may be written without any such provision. The important feature of this contract lies in the fact that if the annuitant outlives the term of years stipulated in the agreement during which payments are to be made, the entire premium paid is earned by the company, and no further payments will be made.

This contract is used when it is desired to provide an income for a limited time. For example, an annuity might be purchased for a young man entering college, providing a monthly payment for him for a period of four years. Such a contract could be written so that if the young man died before the end of the term, the balance of the purchase price would revert to designated beneficiaries.

Life Annuity with Death Benefit. It sometimes happens that a purchaser of an annuity wishes to make provision for final expenses such, for example, as unusual medical expenses and funeral costs. If he places his entire assets in a life annuity without a refund provision, or even if a refund provision is used, he may leave nothing whatever with which to pay funeral expenses. To cover this contingency, special contracts have been devised which provide an annuity for life, with the additional provision of a lump sum cash refund guaranteed to a designated beneficiary.

Deferred Life Annuities. Insurance companies offer a class of annuity contracts under which income to the annuitant does not commence until after a certain number of years or until the happening of some event. A deferred annuity may be written to provide an income at a certain age, or it may be written to provide an income to a beneficiary upon the death of the insured. A deferred annuity may be purchased by the payment of a single premium. A single-premium payment is not essential as in the case of immediate annuities, and for this reason under most contracts the premium is payable in installments during the deferred period. As in other contracts written by life insurance companies, the premium may be paid on an annual, semiannual, or quarterly basis.

The deferred life annuity guarantees an annuity for life, to commence at some definite and agreed-upon future date. In its details the provisions of the contract are essentially the same as the immediate life annuity, differing primarily in the manner in which the premium is paid. Under this form, a person who wishes an income at the age, say, of sixty-five may make provision for it by regular payments when he is a young man. The purchase of an immediate life annuity requires of the annuitant an accumulated sum sufficient to pay the purchase price of the annuity in a lump sum. This is not always a simple matter and certainly cannot be depended upon.

Deferred annuities provide a grace period. There is no refund provision upon the death of the annuitant, and no certain number of payments is guaranteed. Usually such contracts are without cash or loan values during the deferred period, and there is no obligation on the part of the insurer to make payment in case the annuitant dies before the first payment becomes due. In case of failure on the part of the insured to meet his premium payments after a stipulated period, a nonforfeiture provision of the policy provides a paid-up annuity for the insured, based upon the amount actually paid in. As in the case of the immediate annuity, a deferred life annuity may be paid in the form of a single premium. The single premium is the sum of the installment payments, reduced to a present value by taking account of the interest factor used by the company in computing the installment premiums.

Deferred annuities are used primarily by younger people who wish to assure themselves of an income in their old age and take this means of regularly contributing for the purpose. This form of annuity contract is regarded by many as an admirable means of saving. The policy is particularly attractive because of the low premium charge.

Deferred Refund Annuity. In its important features this policy is the same as the deferred life annuity, with the additional stipulation that the aggregate of the amount payable by the company to the insured shall equal the aggregate of the premiums paid for the annuity. As in the case of other life contracts paid on an installment basis, payments may be made annually, semiannually, quarterly, or monthly or may be paid on a single-premium basis.

Some policies of this type make provision for a cash surrender

value. For example, one company provides that if the contract is surrendered after a period of six years and during the lifetime of the annuitant, the company will pay in cash the full sum of the premiums paid. If the premiums have been paid for less than six years, a slight reduction is made from the total of the premiums.

Reversionary Annuity. This contract has sometimes been called a "survivorship annuity" and is, in fact, a combination of two policies. Insurance is placed upon the life of one person, and upon his death the proceeds are used to provide an annuity for a designated beneficiary.

Under this contract, since the payments to the annuitant commence with the death of the other party to the agreement, who is known as a "nominator" or "insured," a medical examination of the nominator is necessary.

Premium payments under this contract usually continue during the lifetime of a nominator and are payable at the same intervals allowed on other insurance contracts. A modification of this form may be written whereby the premiums will be paid for a definite number of years on the same basis as a ten- or twenty-payment life. Other features of the life contract, such as double indemnity in the event of death from accident or disability provisions, may be included.

If the annuitant dies before the nominator, all premiums paid in belong to the company and there is no refund. The contract has no cash or loan value, though after the premium has been paid for a specified number of years under the nonforfeiture provision, a paid-up annuity based upon the amount of premium actually paid in becomes effective. There are many variations of survivorship annuities designed to fit the needs of particular situations. Contracts of this type are designed ordinarily to provide a life income for some dependent. They may be written, however, so that the nominator himself will benefit from the income after he reaches a certain age, with the annuity to continue to a designated beneficiary upon his death.

Retirement Annuities. The retirement annuity is a deferred annuity used by an individual to provide an income for his own retirement by making convenient payments during the productive period of his life. The contract differs from the ordinary deferred annuity

in that a wide degree of flexibility enables the annuitant to adjust the operation of the agreement to meet changing conditions and unforeseen needs.

The outstanding characteristic of the retirement annuity is to be found in the provision which allows the annuitant to select a date for the commencement of payments, other than that written in the policy. For example, a young man at thirty may purchase a contract providing an income of $200 a month when he reaches the age of sixty-five. If, however, because of poor health or for any other reason he wishes to retire at an earlier age, he may, subject to limits provided in the policy, elect to have his payments begin at an earlier age. In such a case, upon request to the company, an earlier maturity date will be substituted for that written in the contract. The amount of the income will be adjusted to such an income as the premium paid would yield for the new date selected.

Retirement income contracts are written with provisions for optional settlements. The first option provides a life annuity, and under this plan the annuitant receives the greatest amount of the income, and it is paid to him for life. Nothing is refunded to a beneficiary upon the death of the annuitant. The second option provides an income for the life of the annuitant, plus a return. This return, added to the payments already made the annuitant, will equal the full amount of premiums paid to purchase the annuity. The final option provides a life income, with payments guaranteed for a number of years certain. Under this form the amount paid to the beneficiary is dependent upon the number of years certain that the contract guarantees.

This contract usually provides for a cash surrender value provided the policy is surrendered before the payments to the annuitant commence. Some policies provide for loans during this same period. An automatic paid-up annuity becomes effective upon default in the payment of premiums.

Group Annuities. The annuity plan has been utilized to provide pension plans for employees. This plan is noted in the discussion of group insurance.

Federal Income Tax. The law undertakes to differentiate in the annuity income between that portion which may fairly be considered to represent income and that portion which represents return of principal. To give effect to this differentiation, an amount equiv-

alent to 3 per cent of the original deposit is considered income and taxable; payments in excess of this amount are not taxed.

The situation changes, however, when the sum of the payments considered as return of principal equals the original purchase price of the annuity. From that point on, the entire return from the annuity must be included in the gross income of the annuitant and is taxable accordingly.

FOR REVIEW

1. Distinguish between the last survivor annuity and the survivorship annuity.
2. What is a last survivor annuity, and for what type of situation is it designed?
3. Distinguish between the single-premium annuity and the single-premium cash refund annuity.
4. Since annuities are dependent on life contingencies, as is life insurance, why in the case of life insurance is the medical examination required but dispensed with in the ordinary course in writing annuities? What types of annuities require a medical examination and why?
5. What is the present value of an income of $1,000 a year, payable at the end of each year for ten years with money at 3 per cent?
6. Some life insurance companies are spending large sums of money in advertising retirement income policies. In commenting upon such an advertisement B, aged twenty-seven, states that he believes in life insurance to protect dependents but that he can provide adequately for his own old age. What do you think?
7. There is a widespread idea that it requires a large sum of money to purchase an annuity, and that ordinarily single-premium annuities are purchased only by the wealthy. Explain that the contrary is, in fact, the case.
8. B wishes to purchase an annuity, and the company insists upon evidence as to his age. B believes himself to be sixty-five years old but in attempting to secure a copy of the record of his birth finds the records to have been destroyed by a disastrous fire fifteen years ago. B cannot understand why his own statement as to his age is not acceptable, when it was never questioned upon the occasion of purchase of several life insurance policies. What is B to do?
9. It is stated that the annuity contract is the reciprocal of life insurance. Explain.
10. There is an annuity contract referred to as the "extra deferred survivorship annuity." Under its terms the income payments to the annuitant are deferred a number of years after the death of the insured. The waiting period before payments begin may be as long as twenty years, or it may be five, ten, or fifteen years. If the annuitant dies before the insured, or during the waiting period, nothing is due under the contract. What possible value or use can such a contract have?

11. If the insurance company obligates itself under the annuity contract to pay at regular intervals a definite sum for life to an annuitant, how is it protected from making payments beyond the life span of the annuitant?
12. B is twenty-five years of age. He purchases a retirement income annuity, selecting the age of sixty for the first payment. Because of unfortunate financial reverses accompanied by broken health, B finds himself at the age of fifty both destitute and jobless, with little prospect of being able again to earn a satisfactory living. Must he wait ten years before enjoying the benefits of his annuity, and must he continue his premium payments during that period?
13. Illustrate the computation of a deferred life annuity, using the American Experience Table of Mortality and a 3 per cent interest rate. To simplify the problem, assume an age of eighty years. Provide a payment of $1,000 after ten years and $1,000 annually thereafter for life.
14. Illustrate the computation of an annuity due with ten payments certain and for life. Assume all other conditions as in Problem 13.

CHAPTER XXXVIII

GROUP INSURANCE

DEVELOPMENT of Group Insurance. The term "group life insurance" is applied to the life plan under which an employer of a large group is enabled to provide life insurance protection to all or to certain classes of his employees. This form of coverage has developed in comparatively recent years. The attention of the insurance world was attracted to the plan when the Equitable Life Assurance Society of the United States issued a policy effective July 1, 1912, covering the employees of Montgomery-Ward Company who had been in the services of the company a year or more. For the first few years thereafter, life insurance companies were slow to follow the example thus set. However, within a few years the plan had caught the attention of employers everywhere, and life insurance companies entered into the active development of the business. Large and important insurance companies are intensively cultivating the field, and it is unquestionable that the plan affords a socially desirable addition to the business of life insurance.

Group insurance includes within its scope not only group life insurance but as well group accident and health insurance, group hospital care insurance, and group annuities.

Definition. Since group life insurance involves certain practices, notably the issuing of policies without a medical examination, the business immediately became a matter for the consideration of the various state insurance departments. It was recognized that in writing insurance for large numbers of individuals in a group, abuses might readily creep in, and it was to prevent these abuses that the insurance commissioners sought and obtained adequate legislation.

In 1918, the National Convention of Insurance Commissioners adopted the following definition of group life insurance:

> Group life insurance is that form of life insurance covering not fewer than fifty employees, with or without medical examination, written under a policy issued to the employer, the premium on which is to be paid by the employer or by the employer and employees jointly, and insuring only all of his employees or all of any class or classes thereof, determined by conditions pertaining to the employment, for amounts of insurance based upon some plan which will

preclude individual selection, for the benefit of persons other than the employer, provided, however, that when the premium is to be paid by the employer and employee jointly and the benefits of the policy are offered to all eligible employees, not less than seventy-five per cent of such employees may be so insured.

The definition was recommended to the several states and has been adopted by most of them. A number of states have adopted laws considerably enlarging the scope of this definition. More recent extensions permit issuance of group insurance policies to units of the National Guard, labor unions, state police, and state troopers.

The Group. In making provisions for a minimum of fifty employees to constitute a group, the number is kept sufficiently large to assure the functioning of the law of average.

In passing from the insurance of medically selected lives to the insurance of groups without medical examination, it would not be the part of wisdom to allow any practice that would permit personal selection against the insurance company. To avoid the element of unfavorable selection, all members of the group must be included, or at least a sufficient number to represent a fairly representative risk.

As a matter of actual practice, the group need not include all classes of employees. Groups within an organization may be arbitrarily established. A policy may be issued covering the clerical force and officials of a business; it may insure only employees with a number of years' service; or it may cover the workers in a given department. A few individuals from one department and others from another, even if the total numbers fifty, are not eligible unless the insurance is offered to all. If only one division of the employees is offered insurance, a few employees of another group may not be included. On the other hand, any arbitrary grouping is permissible so long as the possibility of individual selection is eliminated.

When the premium is paid by the employer, the group is said to be "noncontributory" and the insurance extends to 100 per cent of the members of the group. The group is "contributory" when the premium is to be paid by the employer and employee jointly, and to warrant the insurance such groups must include a minimum of at least 75 per cent of the employees in the class.

Medical Examination. It has been noted that the American Experience Table of Mortality is an ultimate table, and therefore no allowance is made in its computation for medical selection. The

primary function of the medical examination is to prevent adverse selection.

Because of the size of the groups it is assumed that the element of individual selection is removed, or at least reduced to an inconsequential minimum. This justifies the elimination of a medical examination. The fact that each of the insureds under a group policy is in regular attendance at his work raises a presumption of a health condition warranting insurance. If an occasional poor risk is included, the law of averages tends to offset such a risk with the exceptionally favorable cases.

In a few states a medical examination is required by statute. When group policies are issued in such jurisdictions, the insuring company must, of course, comply with all legal requirements. Examinations made under such circumstances, to comply with the law, do not require as much detail as is demanded in the case of the examination of the individual applicant for insurance. Under contributory plans, an applicant may be required to take an examination if he puts off acceptance of insurance for a considerable period after the time he becomes eligible. When a group policy is issued, no medical examination is required except under the conditions here noted, and all members of the group are accepted for insurance regardless of age, sex, and physical condition.

Forms of Group Insurance. Various forms of the life insurance contract have been issued to groups, though the type most widely used is the one-year renewable term plan. As in the case of other term policies, the contract has neither a cash surrender value nor a paid-up value.

The contracting parties are the employer and the insurance company. A master policy, containing the entire contract, is issued to the employer. A certificate of insurance is issued to each employee included under the group policy. The certificate is evidence in the hands of the employee, or his representative, of his interest in the group policy. The amount of insurance is stated, as well as the name of the beneficiary, together with other important provisions that may be included in the original contract, such as the right of conversion or disability benefits.

The right to decline renewal is reserved to the insurance carrier in the event that the group so changes in numbers as to be no longer eligible for group insurance. This is the case of the number of em-

ployees becomes less than fifty during a policy term, or if the insurance is written on the contributory plan and the number of those receiving the benefits of the insurance is less than 75 per cent of those eligible.

Conversion Privilege. Each employee insured under a group policy is usually given the right to continue the insurance as an individual, without medical examination, in the event that for any reason his engagement with the employer placing the insurance is terminated. This privilege allows the employee to convert his insurance under the group plan to any of the policies issued by the company, term insurance excepted, for a face amount equal to that of his group certificate. This right of conversion extends for a period of thirty-one days after the termination of employment.

When the conversion privilege is exercised, the premium charged for the new policy is based upon current rates for the policy required, computed according to the attained age and occupation of the employee at the time of conversion. The right of conversion under older group policies was entirely contingent upon the continuation of the master policy, and failure to renew the group policy terminated any rights of individual certificate holders. Recently, however, some of the newer policies have extended the protection of the certificate holder to the extent of providing that, if the group policy for any reason is terminated, an employee who has been insured for five years may convert to an individual policy, without medical examination, in an amount not greater than the amount of his group insurance, but in any instance not greater than $2,000.

Until recently the right of conversion within thirty-one days of the termination of employment did not carry with it a continuation of insurance without action on the part of the employee. Under the older policies, when employment was terminated, the liability of the insurer to the employee ended. If the employee wished to continue his insurance, he himself was obligated to take the iniative by making application for conversion within thirty-one days. Failure to make such an application resulted in a lapse in the insurance as of the termination of employment. Newer policies have taken cognizance of the danger to the employee in delaying taking steps to convert his insurance. To eliminate this period of no coverage, the newer policies now provide that the employee shall be actually covered during thirty-one days following termination of employment. Ap-

plication for conversion may then be filed after termination of employment, and the new insurance becomes effective at the end of the thirty-one-day period.

In the case of absence from the service of the employer, if the absence of the employee is temporary, occasioned by physical disability or leave of absence, and if the premium is paid by the employer, the insurance may be kept in force. At the option of the employer, a former employee returning to service may be reinstated to his original position or he may be treated as a new employee.[1]

The Beneficiary. It is required that a beneficiary other than the employer be designated. Each employee may designate his own beneficiary, with the result that there are as many beneficiary designations as there are employees insured.

A beneficiary under a group policy has the right to sue the insurance company; but since there is no contractual relationship in the matter of the insurance between employer and employee, there is no right of action against the employer. In the case of noncontributory insurance gratuitously effected by the employer on the life of his employees, he assumes no obligation whatever to keep the policy in force and may at his option discontinue the insurance without notice either to the insured employee or to the beneficiary.

Amounts of the Certificates. After a plan has been made for determining the amount for which an employee may be insured under a group policy so as to preclude individual selection, a schedule of classes or divisions may be set up affording preferences to certain members of the group.

If all the members of the group are insured for a uniform sum, the condition against individual selection is most simply satisfied. It frequently happens, however, that such a plan does not satisfy the requirements of the employer. It may be that he wishes to give preference to older employees and executives, or it may be that the

[1] Absence because of military service has created a considerable problem. When employers elected to keep insurance in force for those in their employ entering military service, insurance companies were obliged to face a situation not contemplated when the contracts were issued. The situation in most instances was solved by an agreement on the part of the employer to pay an extra premium for each employee covered while in military service. Another solution that proved attractive was a provision by the insurance company to provide a waiting period of 120 days after the entrance into military service before the increased premium was charged. This waiting period allowed the employee to arrange for cover under the National Service Life Insurance Act. The parties at interest could then elect as to whether or not the group insurance was to remain effective.

amount of insurance he is willing to pay for on one class of employees is, in his opinion, entirely inadequate for another. To meet his needs in such cases, a schedule of insurance amounts may be set up in the contract providing a different amount of coverage for the different classes.

Schedules most commonly used provide that the amount of coverage shall be based upon: (*a*) annual salary, (*b*) occupation, or (*c*) length of service. Under any of the foregoing plans there can be no individual selection, the amount of insurance to which an employee is entitled being entirely beyond his control and contingent entirely upon the classification in which he finds himself.

When the annual salary is used as a basis for the schedule, the amount of insurance allowed may be a flat sum assigned to different salary groups or a percentage or multiple of the salary. When the basis is occupation, the employees are segregated into such groups as executives, superintendents, department heads, foremen, clerical staff, sales force, and a final inclusive group containing all others not otherwise classified. When the basis is length of service, a schedule is made up assigning the amount of insurance available to new employees, with increasing amounts noted as the length of service increases.

When the plan is noncontributory, the schedule granting small amounts to new employees and rewarding continuous service with increasing amounts has been particularly attractive to employers. When, however, the employee himself contributes to the premium paid, one of the other forms has been found more attractive.

Inception and Termination of Coverage. When group insurance is desired, a form is prepared supplying sufficient information to provide a tentative rate. If the result of the preliminary survey is satisfactory to the employer, an application for the insurance is filed. Upon the company's approval of the plan of insurance selected by the employer, and upon the payment of the first premium or an agreed portion thereof, the insurance becomes effective.

It is not required that the master policy actually be issued or delivered before the company assumes the risk. If, however, the policy is to be issued on a contributory form, the insurance does not become effective until the required minimum number of employees have authorized the deduction from their renumeration as their share of the premium.

Since the policy is written on a yearly-term basis, the master policy expires, unless renewed, at the end of the policy year. A termination of employment terminates the employee's insurance under the group policy.

Probationary Period. In order not to build up an undue expense for the insurance of employees classed as "floaters," the group contract may provide that the insurance is not to become effective for new employees until after they have been in continuous service for a designated period. The length of the period will depend upon the experience of the organization buying the insurance. The limit should be set so that all employees come within the scope of the protection as soon as it seems reasonably certain that they have become settled in their positions.

The Premium. Premiums on the group life policy, whether under a contributory or a noncontributory form, are paid to the company by the employer. When the employees are to share in the cost of the insurance, their contribution is collected in accordance with the terms of an agreement entered into when the policy is written. The usual procedure is to deduct the premium contribution of the employees from the pay roll. This may be paid to the company annually, semiannually, quarterly, or monthly.

The basic rates for group insurance are determined by the industry in which the employees are engaged. The survey made, following the filing of an application for insurance, gives attention to the occupation of the various employees, sanitary conditions, fire protection, drinking water, condition of the property, and the various hazards of yard and plant. When the basic rate is determined, the premium is found for the particular group making the application. This is based upon the amount of insurance carried by each employee and his corresponding age.

The initial premium under a group policy is found by computing a premium on every individual employee and then determining the total. Experience has shown that because of the retirement of a certain number of older employees each year with a replacement in the younger brackets, the age of the group changes little from year to year, and hence the premium is practically stationary.

In industries in which the occupation is classed as extra-hazardous, or in which a substantial percentage of the employees are classed as of a low industrial grade, or which are located in an unhealthy area,

an extra loading is added to the premium for the additional hazard.

Cost. The mortality experience under the group life plan has been favorable. Insurance actuaries have attributed the favorable mortality experience to the fact that numerous employees drop out of the group with advancing years and also to the fact that the entire group must be working when the insurance is effected. Furthermore, an element of favorable selection is found in the care exercised by the insuring company in studying the nature of the hazards involved in the industry when the risk is rated.

In the case of group insurance, there is presumed to be an absence of moral hazard for, because of the very nature of the selection, fraud and speculation are reduced to a minimum. Again, there is an element operating in favor of the company in the fact that in the ordinary course of events the physically unfit and the weaker lives are eliminated, and those who remain are physically fit to carry on their work.

As a result of the operation of the plan, there are certain specific savings not available under the usual insurance plan. Since no medical examination is required, there is a saving of this charge at the outset. Commissions paid on this class of business are substantially lower than those for other classes, thereby reducing the acquisition cost of the business. Finally, the expense in issuing and handling a group policy is less than the cost of handling a large number of individual policies. Hence, the premium for group insurance is substantially lower than that for individual policies.

Studies in various industries have been made as to the actual cost of insurance to the employing company and to the employee. Although the actual cost in each case is dependent upon the hazards of the occupation and the age of the employees covered, it has been estimated that in an average industry the insurance cost will approximate $10 per thousand, or about 1 per cent of the total amount of insurance in force. When the employee himself contributes even a small amount weekly, after dividends have been credited, the burden of a group plan upon the employer is relatively light.

Premium Plans. Group insurance may be paid for entirely by the employer under the noncontributory plan, or it may be paid for partly by the employer and partly by the employee under the contributory or co-operative plan. As a matter of practice, insurance underwriters prefer groups in which the employer contributes at

least in part to the payment of the premium. In the case of groups such as unions in which the funds belong to the members regardless of the source from which the payment is made, the premium in the long run is paid in full by the members.

The earlier group policies were written on a noncontributory basis. Insurance was offered to employees in the nature of a gift or bonus, and when so considered it was deemed proper that the entire cost be carried by the employer. The trend now, however, is decidedly in the direction of the co-operation plan, on the ground that a broader coverage may be offered and because experience has shown that employees must themselves take some initiative in the matter if they are to be expected to inform themselves of what is being done for them.

Wholesale Insurance. If the group is not sufficiently large to meet the requirements laid down for a group policy, wholesale insurance is available on much the same basis. This insurance is for groups of fewer than fifty but more than ten. The essential difference between the wholesale plan and the group plan lies in the requirement of an application for insurance from each employee to be insured. No medical examination is required except for applicants over sixty-five or unless for some reason there is doubt as to the insurability of the applicant. Evidence of the physical condition of the applicant is drawn from the questions answered in the application, and considerable importance is attached to the underwriting of individual risks.

Wholesale insurance affords a small business an opportunity to avail itself of the advantages of group insurance as extended to large concerns. The facilities are essentially the same. The important difference between the group and the wholesale form is to be found in the use of the individual applications for underwriting.

Utility of Group Insurance. While the purpose of an employer in placing group life insurance upon the members of his working force may be genuinely humanitarian, as a rule the attitudes of the employer and employee are quite different.

Employers are concerned primarily with the increased efficiency of their plants. Group life insurance is used as a means to attract superior employees and to retain them in a state of content. It is argued that an employee who is afforded a reasonable degree of security by his employer will be contented to remain and give a more

efficient service than is otherwise the case. Finally, employers have used the purchase of group insurance as a vehicle for publicity.

The position of the employee is quite different. Group insurance provides an opportunity for securing life insurance to many who might otherwise be unable to have any coverage. In any case, a low-cost protection is afforded the employee. He is thereby enabled to augment such permanent program as he may have, and the opportunity is ordinarily regarded with favor.

Aside from the immediate concerns of employer and employee, group insurance is of considerable social consequence. The fact that a large number of workers carry no other insurance than that carried under a group plan places squarely to the credit of this type of protection the prevention of much suffering and distress where dependents are spared the necessity of appealing to charity in the event of the untimely death of the wage earner.

Salary-Deduction Insurance. This plan, also referred to as "payroll deduction," "salary budget," and "salary allotment" insurance, is sold through the personal solicitation of individual employees. It has some points in common with wholesale insurance and affords both employers and employees many of the same advantages.

The salary deduction plan is designed to assist the high-grade employees in building up an insurance program through making premium payments convenient and automatic. Executives, department heads, foremen, and skilled employees are those to whom the plan appeals. Unskilled employees, who may be included for small policies in a group plan, do not make satisfactory participants under the straight salary-deduction plan.

Under the plan, each participant selects the type of policy he wishes to carry. No medical examination is necessary unless required by law. Premiums are payable monthly, the employer deducting the required amount from the salary of the employee and paying it to the insurance company. Policies carrying a monthly premium of less than $5.00 are not written, and usually five or more policies must be written. Premiums may be, and usually are, paid entirely by the employee, though recently the trend has been decidedly in the direction of contribution on the part of the employer.

Group Disability Insurance. Either in connection with a plan to provide group life insurance, or as an entirely separate plan, insurance may be provided on a group basis, through which the employees

of the same employer will be paid a weekly indemnity during a period of total incapacity for work because of sickness or accident. Instead of the broader coverage providing indemnity in the case of both sickness and accident, more limited forms are available providing indemnity only in the event of accident.

Group Health and Accident. This policy is issued to an employer providing blanket coverage to all employees working on a full-time basis for full-time pay. Since workmen's compensation insurance covers occupational accidents, a standard group health and accident policy limits its protection, in the usual case, to illness and accident disability from nonoccupational causes. The policy, however, may be written on what is termed the twenty-four hour coverage, in which case, accidents occasioned in line of employment are covered. This form is desirable where there is no workmen's compensation requirement, but is not an acceptable substitute for workmen's compensation.

The minimum number of employees to constitute a group for disability coverage is twenty-five. Under a contributory plan, at least 75 per cent of groups containing over fifty persons must participate. In groups of fewer than fifty, the requirement for participation increases, being as high as 85 per cent in the smaller groups.

The weekly indemnity is usually based upon a percentage of the employee's earnings, though it may be a fixed amount graded upon some predetermined basis, such as is followed in fixing the amounts under the life policy. The usual coverage is 66⅔ per cent of the employee's weekly earnings. An upper limit to the weekly indemnity for each individual is $40 in groups of more than fifty and $25 in smaller groups.

Indemnity for accidental injury may begin with the onset of disability, but no indemnity is payable for sickness until after the third day. At the option of the insured, the waiting period may be extended, and because of the lower rate, one to two weeks is the more usual term desired. The indemnity period may extend to a year but frequently is less.

Accidental Death and Dismemberment. This is a supplemental coverage, written either with a group life or with a group disability policy, and not otherwise. The coverage provides a lump sum payment in the event of death or certain enumerated disabilities resulting from bodily injuries sustained directly and independently of all

other causes through accidental means. Suicide, whether the insured is sane or insane, is not covered.

The full amount of the insurance is paid for the loss of both hands, both feet, both eyes, or a loss involving any combination of two of the foregoing members. The loss of any one of the members mentioned calls for the payment of one-half the principal sum. Policies are written in a minimum amount of $500, and when written in connection with a group life policy the amounts of each are usually identical. This policy may extend to cover all injuries, whether accidental or otherwise, and in addition to the dismemberment feature provides, in effect, a double indemnity coverage in connection with the group life policy.

Group Annuities. Many employers have recognized an obligation of making some provision for the declining years of employees who have devoted the span of productive years to faithful and loyal service. Various pension plans have been inaugurated to provide for retirement, but the success of their operation has sometimes been curtailed by a failure to estimate adequately the needs of such a program and to set up reserves therefor.

Recognizing that a pension plan of any sort involves a substantial amount of technical detail, and that to be sound it must be based upon actuarial data, employers have sought to turn their problem over to specialists. Life insurance companies have been able to afford the required service through the development of a group annuity.

The group annuity is written on a master policy, covering all employees to be included in the group. It may include all employees of a single employer, or it may include all who elect to participate under a co-operative plan. As in the case of group life, certificates are issued to employees showing their coverage under the master policy. Unlike the group life policy, the annuity has a surrender and paid-up value. If the annuity is written on a co-operative basis, the employer's contributions are usually reserved when an employee terminates his employment, and the employee gets only a refund of the premiums actually paid in by himself.

With the enactment by Congress of the Social Security Act there was at first a tendency to feel that here the matter of pensions was adequately covered and the need for privately operated pension plans no longer existed. Such a conclusion proved to be erroneous. The effect of the Social Security Act has, in fact, been to focus attention

upon the needs for retirement income. The provisions of the Social Security Act are now generally regarded as a bare minimum, to be augmented by private retirement plans designed to meet more adequately the needs of the beneficiaries.

The enactment of the Social Security Act has served as a stimulus to the underwriting of private plans. In those institutions in which an adequate plan was in effect prior to the passage of the act, steps have been taken to adjust the two plans. New plans, as they are inaugurated, use the Social Security benefits as a base and then provide for additional payments by the employer and employee to an insurance company so that the benefits obtainable under the act will be augmented by the payments from the insurance company.

FOR REVIEW

1. There are fifty employees working for the X Company. It is stated that 75 per cent of the employees of a plant must be insured before a group insurance policy may be written. Forty employees are listed in the application. May a group policy be written?
2. B, the manager of X Corporation, contends that premiums paid for group insurance should be allowed as corporation expense deductible from taxable income. He makes inquiry of the Collector of Internal Revenue as to whether life insurance premiums are deductible from taxable income and is told that they are not. Advise B.
3. It is stated that since J is carrying a $1,000 group insurance policy at a premium less than B, who is the same age, is obliged to pay for insurance, group insurance is discriminatory in favor of the employees of institutions where group insurance is available. Justify the legality of group insurance with this point in mind in the light of antidiscrimination legislation.
4. The Blank Manufacturing Company has carried on a survey throughout its plant and finds that approximately 35 per cent of the workers carry no insurance. In a large number of cases the investigation brings forth the fact that, in the past, many of the families of workers have been obliged to break up following the death of the wage earner. The investigation further elicits the information that 25 per cent more of the employees carry only sufficient insurance to meet funeral expenses. The average insurance in force for the remaining 40 per cent is about $1,000. The president of the company wishes to correct this situation but is fearful lest those most in need of insurance will be eliminated as physically unfit. How is the problem of physical disability handled under the group contract?
5. The X Manufacturing Company has fostered the organization of a mutual aid society to assist employees upon the occasion of the death of one of their members. For this reason it is contended that a group life insurance policy is unnecessary. Assume that the company does not feel obligated

to foster an insurance program in excess of that necessary to take care of the crisis immediately created by death. Is the contention correct?

6. It is stated that the largest amount of group insurance in any one year is written during the months of November and December. Can you offer a hypothesis to account for this development?
7. In spite of a generous group insurance program, the executives of the X Company express disappointment in the labor turnover they are experiencing. It was expected that the group insurance would be an important factor in reducing this. In your opinion, were the executives justified in their expectations?
8. In your opinion, would the National Guard constitute a group eligible for a group policy?
9. Is the incontestable clause made a part of the group policy? If so, in the light of the fact that the policy is issued to employers on the life of employees for a beneficiary other than the employer, discuss its effect.
10. The trustees of X University have been trying to work out a retirement plan for the members of the faculty. A committee is appointed, and one of its members suggests looking into the possibilities of a group annuity. In your opinion, is it wiser to pay the insurance company a premium with its loading for expense or have the committe undertake to set up a fund to be administered by the college?
11. B works for the X Manufacturing Company operating one of its machines. He has availed himself of the group insurance offered to all employees. In addition to life insurance, the company provides group disability insurance. In the course of his employment B's hand was caught in a machine, and it may be necessary to amputate it. B's prospects of returning to work in the near future are slight, and he may be permanently disabled. He is now dismayed to hear from the company writing the group disability policy that the company is not liable to pay benefits for the accident. Explain to B why this is so.
12. Distinguish briefly the points wherein wholesale insurance differs from group insurance.
13. It is stated that the functions of group insurance are threefold:
    a) To the employer
    b) To the employee
    c) To the community

    Accepting the benefits to employer and employee as self-evident, discuss the possible benefits of group insurance to the community.

PART VI

FIDELITY AND SURETY BONDS

Chapter XXXIX

GENERAL CONSIDERATIONS

Nature of Suretyship. The contract of "suretyship" is primarily a credit device. It is an agreement whereby one person is answerable for the acts or neglect of another to a third person. The person holding himself responsible is the "surety," and the one for whose debt or obligation the surety is responsible is the "principal debtor," or is more commonly referred to as the "principal," or "obligor." The person protected by the agreement is called the "obligee," and the agreement itself is a "bond."

Under the contract of suretyship, in contrast to the usual contract of insurance, there exists a right of indemnity between the surety and the principal debtor. In the event that the surety is called upon by the obligee to make good a loss under the bond, the surety in turn may proceed against the principal, who is primarily liable on the agreement. Under the usual insurance agreement, when the insuring company is called upon to pay a loss it has no right of action against any party to the contract.

Early Development of Suretyship. Before the advent of the corporate surety, when persons acting in a fiduciary capacity or occupying a position of trust were required to give bonds with sureties, they were obliged to appeal to relatives or friends. Individuals acting as sureties usually did so as a favor and without compensation.

In the period around 1720, when many strange insurance proposals made their appearance in England, a company offered to insure masters against loss through the dishonesty of their servants. This is sometimes said to mark the first attempt at corporate suretyship. More definitely, the corporate fidelity business was established in 1840 with the organization of a company in England to write the business. The first American company was organized in New York in 1853.

Corporate suretyship was slow in developing. In the beginning it was found hard to substitute the impersonal corporation for locally known personal surety. The great reluctance of individuals to assume gratuitously obligations in which they had no immediate inter-

est helped the development, however. With the acceptance of corporate sureties for legal purposes, the business grew, and individuals became increasingly reluctant to obligate themselves when corporations, for a consideration, were readily available.

At the present time, the writing of the many forms of corporate bonds is an important business enterprise. It is unusual for individual sureties to be offered, and it is not at all unusual to find the party to be protected by the bond specifying corporate surety and declining to accept individual surety.

Advantages of Corporate Surety. The corporate bond places bonding on a business basis. Under a corporate bond, the principal has been spared the necessity of asking from a friend a favor which the friend may be extremely reluctant to grant. By asking such a favor, the principal in turn has placed himself under obligation to the surety and may be called to return it upon unfavorable terms. The personal surety in turn involves his own credit with a contingent liability and may jeopardize his property or involve himself in costly and prolonged litigation. The corporate bonding company is organized for profit, makes a charge for its services, and the element of favor or obligation is entirely eliminated.

A second feature that has tended to make corporate bonds attractive lies in the certainty of the protection they offer. An individual surety, at the time the bond is given, may be well able to meet the obligation he assumes, but financial reverses may at any time change his status without knowledge of the other parties to the bond. It is easy to investigate the standing of a corporation carrying on this type of business and to keep informed of its condition.

Corporate Suretyship Insurance. Courts as a rule have a tendency to favor the person who undertakes to answer for the obligations of another. As an outgrowth of this tendency, there has developed the rule that contracts establishing the relationship are strictly to be construed in favor of the surety.

With the advent of the corporate surety company, the courts have given a different interpretation to the bonds upon which these companies appear as sureties. It is pointed out that, in contrast to the simple obligation of the individual assumed gratuitously as a friendly act, the corporate bond is issued by the company acting as security for a compensation fixed by itself. A further difference lies in the use by the security company of a contract drawn by itself, in which numerous

clauses are incorporated setting forth or limiting the company's liability. As a result of these differences, the courts have held that in the case of a bond issued by a surety company the rule of *strictissimi juris* does not apply, and that the contract is to be interpreted as a contract of insurance and not one of suretyship.

The bond of a surety company follows in its general form the contract of suretyship. If it is regarded as a contract of insurance, instead of suretyship, the obligee occupies the position of the insured, and, following the rule of insurance law, the contract is interpreted in his favor wherever ambiguity or uncertainty exists. This is the opposite of the rule of *strictissimi juris,* which favors the surety and permits him to stand upon the strict terms of his undertaking.

Surety bonds are handled by agents writing other lines of insurance, and the contract is in many respects similar to the contract of insurance. In its formation it is markedly different. Under the terms of a surety agreement, one party becomes answerable to a third party for the acts or neglect of a second party. Insurance, on the other hand, is a direct obligation on the part of the insurer to indemnify the insured in the event of the happening of an unfavorable contingency included in the perils clause of the policy. The insurance underwriter anticipates that there will be losses, the outgrowth of the happening of the contingency covered by the policy. In the surety contract, on the other hand, the undertaking of the surety is secondary. The agreement is drawn in such a form that the surety is not liable until after the failure of the principal to perform a specified obligation. Failure may be occasioned by dishonesty, incompetence, or lack of resources. The surety underwriter, therefore, after giving due weight to the nature of the obligation covered by the bond, is interested particularly in knowing the qualifications of the principal to fulfill his undertaking. As a matter of theory, surety bonds are written on the assumption that there will be no losses. They are written to strengthen the credit or provide a guarantee for the principal, and if the principal fails or defaults the surety is liable. The surety, in turn, may have recourse to the principal for reimbursement. This right is frequently of little value, since if the principal could have performed his obligation there would have been no default.

It is because of the form of the contract that it is held to differ from insurance. In the strict sense, the surety contract is not a con-

tract of insurance. When individuals act as sureties, the agreement has nothing in common with the contract of insurance. As a matter of actual practice, corporate suretyship is, in fact, regarded as part of the insurance business. This has been admirably pointed out by a bonding executive in the following terms:

> Gearing the surety business to the countless varied demands of those who seek its protection has developed it in many ways along the lines of insurance. On analysis, however, the similarity is found to be in the method of doing the business while on the other hand the contract of suretyship and its obligations have remained in all essentials unchanged and unlike a policy of insurance. You have noted that the corporate organization for writing surety business is closely akin to that of insurance companies, fire, theft and casualty. The executive, agency and claim administration are smiliar. Premium collection, reserves and claim payments are handled very much as in insurance. Applications and forms have many likenesses to those of insurance. Then, too, the large reserves which have had to be established, the necessity for keeping rates adequate and not discriminatory, the wide spread of business, its special need for standardization have all tended to show the operation of bonding companies like those of insurance companies to be concerned with the public welfare, and therefore supposed to require governmental regulation. Thus because of similarity of methods and operation and for purposes of legislative control surety companies have been classed as insurance companies.[1]

Entirely aside from the association of the surety business with the business of insurance, the courts have tended in construing surety contracts to regard them as contracts of insurance. As part of the reasoning that leads to this decision, the courts have indicated that the corporate surety is in the business of writing surety contracts for a premium and, thus, is in quite a different position from the individual surety who, more frequently than not, assumes his obligation gratuitously and as a friendly act. Even though the corporate bond in fact follows the general form of the contract of suretyship, it is in law, for the purposes of interpretation, regarded as a contract of insurance.

It may be conceded that a literal interpretation of the form of the agreement may take the surety contract out of the definition of insurance. In a broad sense, however, the surety contract is in fact the purchase of certainty on the part of the parties requiring a bond; and because of the association of the surety business with the business of insurance and because of the attitude of the courts in the interpreta-

[1] Brodsky, John C., "Surety Fundamentals and Obligations," *The Weekly Underwriter*, January 27, 1934, p. 210.

tion of surety contracts, for all practical purposes the surety business may well be, and generally is, included as a part of the business of insurance.

Form of the Bond. A bond obligates the surety to indemnify the obligee in the event the principal fails to perform a specified obligation without answering in damages for nonperformance. The bond contemplates that only upon the failure of the principal to perform his obligation, or pay damages, shall the surety be called upon. The principal always guarantees to reimburse the surety or save him harmless from loss, and therefore only in the event of the insolvency of the principal does the surety stand to lose.

To cover the risk, the terminology of the bond differs from that of the policy. The liability of the surety is in most cases limited to a stipulated sum. The parties bound as principal and surety are named with the further statement that they are firmly bound to the obligee for the stated amount, the condition of the bond being that the principal shall faithfully perform the obligation described. Upon performance of the obligation by the principal, the bond becomes void and without effect. This is in contrast to the insuring clause of the insurance policy which makes the company primarily liable for loss to the insured in the event of the happening of the contingency insured against.

The form of a bond may be determined from the following example of a building bond used as standard by the American Institute of Architects:

Know all men: That we [name and address of contractor] hereinafter called the principal, and [name and address of one or more sureties], hereinafter called the surety or sureties, are held and firmly bound unto [name and address of owner], hereinafter called the owner, in the sum of—dollars for the payment whereof the principal and the surety (or sureties) bind themselves, their heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

Whereas the principal has, by means of a written agreement, dated . . . . , entered into contract with the owner for [describe the nature of the operations covered], a copy of which agreement is by reference made a part hereof;

Now, therefore, the condition of this obligation is such that if the principal shall faithfully perform the contract on his part, and satisfy all claims and demands incurred for the same, and shall fully indemnify and save harmless the owner from all cost and damage which he may suffer by reason of failure to do so, and shall fully reimburse and repay the owner all outlay and expense the owner may incur in making good any such default, and shall pay all persons who

have contracts directly with the principal for labor or materials then this obligation shall be null and void, otherwise to remain in full force and effect.

Provided, however, that no suit, action or proceeding by reason of any default whatever shall be brought on this bond after . . . . months from the day on which the final payment under the contract falls due.

And provided, that any alterations which may be made in the terms of the contract, or in the work to be done under it, or the giving by the owner of any extension of time for the performance of the contract, or any other forbearance on the part of either the owner or the principal to the other shall not in any way release the priincipial and the surety or sureties, or either or any of them, their heirs, executors, administrators, successors, or assigns from their liability hereunder, notice to the surety or sureties of any such alteration, extension or forbearance being hereby waived.

Signed and sealed this ..... day of ....., 19.....

In the presence of

....(Seal)

....(Seal)

Penalty of the Bond. When a designated sum is written into the bond as a limit of the liability of the surety, the sum so written is termed the "penalty," and the bond is termed a "fixed penalty bond." The penalty corresponds to the face of an insurance policy.

Bonds are written in which no amount of penalty is fixed. Such a bond guarantees that the surety will pay whatever damages arise from the nonperformance of the obligation assumed by the principal. Such bonds are known as "open covenant bonds."

Fidelity and Surety Coverages. Bonding companies arbitrarily divide bonds into two classes: (*a*) fidelity bonds and (*b*) surety bonds. In the strict sense, all corporate bonds in which a surety agrees to answer for the nonperformance of a principal are surety bonds. The difference between a fidelity and a surety bond lies in the nature of the obligation. In the case of a fidelity bond, the obligation is implied rather than contractual, and the bond undertakes to reimburse an obligee for loss of money or property growing out of dishonest acts of the principal. The surety bond, on the other hand, obligates the surety to hold himself responsible for the performance of an expressed obligation. Fidelity bonds are used to cover an employee in a position of private trust and guarantee the employer against loss due to the dishonesty of the employee covered. To prove a loss under a fidelity bond, it follows, therefore, that the principal must have been guilty of a dishonest act. In the case of surety bonds, the coverage is considerably broader. While a dishonest act may give

rise to a loss, it is likewise true that negligence and lack of ability on the part of the principal may create a liability on the part of the surety.

The Obligation to Bond. It is important for those who hold positions of trust to understand that losses to property in their care occasioned by their negligence carries with it a personal liability. It has been held by the courts that failure to provide fidelity coverage upon an officer of a bank by the directors is negligence, and the directors may be held liable for dishonesty losses. The effect of such a rule is to place the responsibility of adequate fidelity bonding of bank employees squarely upon the directors, and failure on their part to take the necessary steps may result in their being obliged personally to make good losses that occur. Statutory requirements may be regarded as minimum requirements. What constitutes adequate bonding coverage must be decided by the circumstances surrounding each particular case.

The Question of Capacity. To be bound on a contract of surety, the party to be bound must have the capacity to enter into the engagement. Since the same rules apply as in other forms of contract, the agreement of an infant is voidable, as is that of an insane person, a drunkard, or any other not in a position to give his consent freely.

In the case of corporate suretyship the capacity of the corporation to enter the agreement would rarely be a matter for question, though in the event of the incapacity of the principal the question of the liability of the surety is sometimes raised. It is settled that if the principal is an infant, insane, or otherwise incapacitated, this defect does not affect the liability of the surety, and this is true even when the surety becomes a party to the agreement without knowledge of the incapacity of the principal, unless induced through fraudulent concealment or misrepresentation. There is neither illegality nor incapacity on the part of the surety, and the surety is therefore bound. If the contract of the principal is void because of positive illegality, the agreement binding the surety is likewise void and without effect.

The Effect of Fraud. If a surety has been induced by fraud of the principal to become a party to the bond, this fraud will not constitute a defense against an innocent obligee who has acted relying upon the bond.

As to the obligation of the obligee to inform the surety of facts having a bearing on the risk, there has been some uncertainty. It was

originally held that the contract was *uberrimæ fidei* and, as in the case of marine insurance, the insurer was entitled without inquiry to all information affecting the risk known by any party to the agreement. The opinion now prevails that the contract is not *uberrimæ fidei* and that a surety, entering into a contract, will have taken steps to secure such information as is required.

When inquiry is made by the surety and disclosures by the obligee are incomplete, insufficient, misleading, or false, the contract is jeopardized. If questions are put to an employer in the form of an application and the answers are not true, the surety may be released from his obligation if the misrepresentation is material. If the answers in the application are declared to be warranties, incorrect information, whether the result of carelessness or the intent to mislead may void the obligation of the surety through the operation of the doctrine of warranties.

Waiver and Estoppel. As in the case of other contracts of insurance, the doctrines of waiver and estoppel apply in connection with surety bonds. When a surety company delivers a bond, knowing a cause for holding it invalid, the delivery amounts to declaring the contract to be valid; and the defense is waived. The same is true if a premium is accepted with knowledge by the surety of an existing defense.

Again, if a company proceeds to adjust a loss, knowing that strict compliance with the contract conditions as to notice or proofs of loss is lacking, it will be held to have waived such compliance. If a company has held incomplete or insufficient proofs until the time for filing satisfactory and acceptable proofs has elapsed, it will be estopped from denying liability on the ground that the proofs retained were insufficient.

Operation of Statute of Frauds. Unlike other contracts of insurance, which are usually in writing but which need not necessarily be, surety contracts fall within the statute of frauds. Enactments in the various jurisdicions in the United States follow generally the English statute which provides that:

> No action shall be brought whereby to charge the defendent upon any special promise to answer for the debt, default, or miscarriages of any other person, unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith or some person thereunto by him lawfully authorized.

Contracts falling within the statute must be in writing and signed by the party to be bound.

Assignment. Contracts of guaranty and suretyship are, as a general rule, assignable. This rule holds even before a breach unless, by its terms, assignment of the contract is limited or restricted. Fidelity bonds are not assignable before a loss without the consent of the surety because, by the very nature of the agreement, a definite principal is contemplated by the company, and another therefore may not be substituted without first obtaining its consent.

Subrogation. In contracts of suretyship, upon the payment by the surety of a debt of the principal, the surety is subrogated to all the rights of the creditor against principal whose debt has been paid. This includes all securities, funds, liens, priorities, or equities held by the creditor as security. When the surety fulfills an obligation of the principal, it is subrogated to the rights of the principal in the engagement.

In the case of cosureties, that is, when more than one surety is liable equally on the same obligation, if one of the sureties pays the obligation in full, he has a right of contribution from the others.

Acts Operating to Discharge Surety. When a surety is liable for the honesty of an employee, the principal, upon the discovery of any dishonesty in connection with the duties for which he is bonded, is obligated to dismiss the dishonest employee at once or to continue him in his position only after having secured the consent of the surety. Failure to follow this procedure will release the surety from any liability for loss occasioned by further dishonest acts of the employee. In the case of suretyship for the officers or agents of corporations, where a conspiracy between such officers or agents might have the effect, if the rule were followed, of discharging all sureties and therefore defeat the purpose of the bond, the rule does not apply. Acts of immorality outside the guaranteed employment need not be disclosed.

Unless provided in the bond, no particular degree of supervision over the bonded employee is required. It is usual in the case of corporate fidelity bonds to require periodic examinations or audits of the principal's accounts. The requirement may be incorporated in the body of the bond or as a part of the application. In either instance, the provisions are in the nature of warranties, and failure to comply fully therewith affords grounds for relieving the surety.

If the bond secures a contract, a material alteration in the contract by the obligee without the surety's consent has the effect of releasing the surety. Contractors' bonds, as a rule, contain a clause permitting changes, alterations, or additions without the consent of the surety. Even with this clause, if a change is such that the work becomes essentially different from that originally contemplated, there is ample precedent to indicate that the nonconsenting surety may be released.

Use of Cosureties. Bonds issued in very large amounts are sometimes signed by more than one surety. Each company obligated on such a bond is known as a "cosurety." Under the terms of the bond, a limit may be set on the liability of each surety. This is not always the case, and when the individual limits of liability for the cosureties are set, it becomes necessary to do this through the agency of an agreement entered into between the sureties, known as a "side agreement."

Reinsurance. The laws of the various jurisdictions in this country fix a limit to the liability to be assumed by a surety company on a single risk. When attractive business is offered but the limit of liability is in excess of that which the company may legally assume, or is willing to assume, it may write the bond and reinsure the excess liability with other surety companies, just as insurance companies reinsure their excess lines.

Indemnitors. An indemnity agreement is used when a bond is required by an applicant whose financial position or background of experience is such that he is just short of meeting the company's standards. The indemnitors are individuals who assume much the same responsibility in connection with the writing of a surety bond as that assumed by an accommodation endorser of commercial paper. In the event of a default on the part of the principal, the indemnitors assume the obligation. The surety, if called upon, may in turn seek reimbursement from the indemnitors.

It is frequently asked upon what grounds a surety company can justify asking for indemnitors if it is in the business of surety underwriting and is paid a premium for assuming the risk. The answer is the same as that which justifies a bank in the business of lending money requiring endorsers before lending upon an unsecured note. The credit of the applicant is otherwise insufficient.

Considerable misunderstanding sometimes arises when indemnitors are called upon to fulfill the obligations assumed under the indemnity agreement. Optimism on the part of the applicant for the

bond and an impatience to place the business on the part of the company agent sometimes result in an incomplete understanding of his position by the indemnitor. The tendency to regard the agreement as a "mere matter of form" frequently leads indemnitors into unforeseen and unconsidered difficulties.

Surety companies are insistent that, if a bond is written with indemnitors, it is the duty of the agent to see that the agreement is carefully read by all parties thereto and that the obligation to pay is clearly understood.

Rates. For the purposes of rating, fidelity and surety bonds are separated in the manual into six classes as follows: (1) fidelity, (2) judicial, (3) contract, (4) depository and miscellaneous, (5) license and permit, and (6) federal.

Rates so far as possible are based upon a loss experience from the class, or upon the cost of servicing the bond, or both. Surety bonds present a problem for rate-making purposes entirely different from that to be found generally in the insurance field. A statistical background setting forth the experience of the class to be insured is available in the fields of life and property insurance. Rates are made on the basis of averages. This is not possible with surety bonds, for averages cannot be used since in this field risks are carefully selected with a view to covering only responsible parties who are themselves expected to fulfill the obligations assumed. In the field of blanket fidelity bonds, large groups are covered and insurance principles are more readily applicable.

Premiums fall into two general classes. The first class includes bonds where a fund must be accumulated to pay losses, as in the case of fidelity bonds. The second class includes bonds where service is the feature emphasized. Here the costs are primarily those of investigation and supervision.

FOR REVIEW

1. The laws of a certain state require bank officers to be bonded in the amount of $25,000. To what extent may the directors of the bank feel that by complying with the minimum legal requirements they have adequately protected the funds entrusted to their care?
2. B was elected to the Board of Directors of the First National Bank. Shortly afterward a new cashier was hired and ordered to furnish a bond in the amount of $25,000. The directors neglected to check up on this matter, and the bond was never filed. In the course of several years a huge shortage

developed, and B was asked to contribute with the other directors in restoring the amount of the loss to the bank, on the ground that the directors were negligent. B refused on the ground that this was the responsibility of the president of the bank. In your opinion, will he be forced to contribute?

3. What is the function of an indemnitor in the field of corporate suretyship?
4. Distinguish briefly between the surety contract and the contract of insurance.
5. Distinguish between the underwriting problems of the fire insurance underwriter and the surety underwriter.
6. Fidelity bonds cover what classes of risk?
7. B has always placed his insurance with the X agency. He has been in the habit of calling this agency from time to time as he requires insurance coverage, instructing the agent to bind the needed coverage and deliver the policy when convenient. Under what disadvantage does B operate in undertaking to have a bond coverage so bound?
8. X, an employer, is offered a fidelity bond which covers against loss occasioned by larceny or embezzlement on the part of any employee. Criticize this coverage.
9. B has been appointed by the probate court to adminisiter the estate of X, deceased. X had two minor children, aged three and five, respectively. B has likewise been appointed guardian for the children. His brother, who is a very wealthy man, agrees to become surety for B on the bonds required by the court. If B's brother is willing to do this, why should those interested in the welfare of the children object?
10. B, a general contractor, is the trustee of a large estate. For a period of five months he leaves a sum of $50,000 belonging to the estate on deposit with his bank in his own name. He does this for the purpose of establishing the reputatioin of having a large bank balance when it becomes necessary to secure a contract bond. On July 15, 1937, he files an application with the X Surety Company. The company verifies the balance and issues the bond. X transfers the funds back to the estate. A claim is filed under the bond, and the company refuses to pay on the ground that the application was fraudulent and the bond was obtained through the agency of a deliberate misstatement of material fact. Advise the claimant.
11. B, an agent for the Blank Surety Company, prepares and signs a contract bond for $500,000. His authority is limited to $50,000. What is the position of the obligee in the event of a claim?
12. Distinguish between a contract of guaranty and a contract of surety.
13. B enters into a construction contract, and his father signs his bond as surety. What effect upon the contract has the death of the surety?

CHAPTER XL

FIDELITY BONDS

CLASSIFICATION of Bonds. Fidelity bonds are classified in several ways. As to extent of protection, bonds are written to cover loss occasioned by: (*a*) larceny and embezzlement, and (*b*) dishonesty. For underwriting purposes, bonds are divided into: (*a*) bonds required by private employers to cover loss through dishonesty of employees and (*b*) bonds required of public officers for the faithful performance of their duties. As to form, bonds are written as follows: (*a*) individual form, (*b*) schedule form, and (*c*) blanket form.

The larceny and embezzlement form restricts the coverage to those losses caused by some act of the principal amounting to larceny or embezzlement. Because larceny and embezzlement are crimes, some companies insist upon conviction before admitting liability. The limited coverage of the bond is not attractive to employers. The dishonesty form covers the employer against pecuniary loss through any dishonest act of the employee.

Individual bonds, as the name implies, are written to guarantee the employer against misappropriation on the part of a named individual. If a group of employees is to be guaranteed under one instrument, the schedule form is used, though under this form each employee is bonded for a specified amount. Blanket bonds group all employees and insure the group for a lump sum, instead of insuring each member for an individual amount.

A fidelity bond guarantees the employer against loss, should the person or persons covered by the bond prove to be dishonest. Because of this limitation to coverage of losses the outgrowth of dishonesty, it follows that, lacking a dishonest act, there can be no loss under the bond. This is not the same in the case of surety bonds. Since a surety bond is conditioned upon the performance of certain obligations, it follows that the principal may still be honest and, nevertheless, because of inability to perform his obligation, a loss may result to the surety. Honesty may frequently be a deciding factor contributing to a loss in the case of surety bonds; however, the fundamental difference between a fidelity and a surety bond lies in the fact that the surety bond covers performance of an obligation, and

even though the principal is honest a loss is nevertheless possible. In contrast to bonds issued to private individuals, bonds required of public officials are in their nature fidelity bonds because they cover against dishonest acts; But because, in addition to the guarantee of honesty, there may be a further guarantee of capacity to perform faithfully the duties of the office, bonds required of public officers are classified by the companies for the purposes of underwriting as surety instruments.

Term of Fidelity Bond. Fidelity bonds may be written either on an annual or on a continuous basis. When written on an annual basis the bond expires at the end of the term, as does the ordinary insurance policy. The continuous bond remains in force until canceled. A bond written on an annual basis may be continued in force by the issuance, on the part of the company, of a renewal certificate. No certificate is required in connection with the continuous form; and, if premiums are paid when due, the bond remains in force until one party or other to the agreement takes steps to effect termination.

Fidelity bonds may be canceled at any time by the employer or the bonding company. Conditions governing procedure are incorporated in the bond. Annual bonds, therefore, terminate automatically; but continuous bonds, unless canceled, cover the employee indefinitely, terminating, however, on his death, resignation, or discharge.

Name and Position Bonds. When schedule bonds were first written, the name of each employee to be covered was listed, and opposite his name was entered the amount for which he was bonded. In the case of large concerns, where simplicity was essential, a considerable degree of detail was necessary to keep account of changes, and the danger of an omission was ever present. A step in the direction of simplification was taken by providing that schedule bonds might be written designating positions instead of names. When so written, the positions to be covered are listed on the schedule, and whoever is employed to fill that position is bonded. Where there are several employees in a given class, the class is scheduled, and a premium paid for the total number of employees. All in the group are thereafter covered, regardless of changes.

The position form was first written for fraternal orders and covered subordinate or supreme officers by position. The evident convenience and simplicity of the coverage readily manifested itself,

and it is now used for other schedule coverages. The position form has by no means entirely superseded the name form, and schedules are still widely used in which each employee is individually listed by name.

American Bankers Association Form. This form provides a very broad coverage and takes its name as a result of its approval by the American Bankers Association. Unless specifically requested, bonding companies do not ordinarily use the form but do not refuse to execute it when a preference for it is indicated. From the insurance company's standpoint the form is objectionable, since the liability of the surety continues indefinitely after premium payments have terminated. Other bonds provide a limit within which a loss must be reported. Under the American Bankers Association form the company is liable if the loss occurs during the period of coverage, regardless of when it is discovered and reported.

Culpable Negligence Endorsement. In addition to covering against loss occasioned by the dishonest act of an employee, a fidelity bond may be extended by endorsement to cover losses occasioned by culpable negligence. Culpable negligence is carefully defined in the endorsement, but in general terms it may be said to be the willful violation of instructions at the risk of causing loss to the employer. The form was used originally by railroads to cover themselves against loss resulting from agents who, contrary to company rules, delivered goods shipped without collecting the freight. The coverage is now generally available with other fidelity bonds. The risk of loss from this source is not regarded as great.

Classes Covered. The list given here of employees who may be covered under a fidelity bond is by no means complete but serves to indicate, in a general way, the broad use of the form. Private employees of whom bonds are required include corporation officers such as president, treasurer, auditor, and the like, managers and superintendents, branch managers, bookkeepers, clerks, salesmen, drivers, collectors, stock clerks, porters, watchmen, messengers, demonstrators, traveling salesmen, purchasing agents, paymasters, timekeepers, consignees, brokers, and sales agents. To this list may be added officers of fraternal organizations.

In the public official group are included tax collectors, their assistants, deputies and subordinates; city and town treasurers; officers and employees of the public school system; officers and employees of

charitable, reformatory, and penal institutions; treasurers and collectors appointed in connection with the operation of highways, turnpikes, and bridges; state officials such as treasurer, secretary of state, auditor, insurance commissioner, highway police, wardens, inspectors, and the like. Officers of the National Guard, as well as county, city, town, and village officials, are included in the category.

Fidelity Underwriting. In fidelity underwriting the hazards are divided, as in other forms of insurance, into the moral and the physical. In this case the term "moral" or "personal hazards," however, is used in a narrower sense than in the case of property insurance and is concerned directly and immediately with the ethical attitudes of the person to be bonded.

Physical hazard in fidelity underwriting has to do with the ability of the employee, with his surroundings, and with his experience. The underwriter is interested in knowing the income of the employee, his opportunities to be dishonest, and the situations that might present a temptation. For example, a young man working for a very small wage while learning a business would be less liable to steal, other things being equal, if he had an independent income than if dependent entirely upon his earnings. The underwriter is interested in the ease with which an employee might cover a theft. Failure to make thorough, periodic audits, and opportunity temporarily to make up a shortage in one fund by drawing on another or to carry forward a shortage from year to year are sources of physical hazard.

In addition to making a careful check upon the background, reputation, and business experience of the person to be bonded, the company is always interested in knowing the conditions under which he will work and the existence of any pressure that may result in dishonesty.

Preferred Risks. Fidelity underwriters commonly divide all employees for the purpose of classification into inside and outside risks. Inside employees, as the term indicates, are the cashiers, bookkeepers, clerks, and other office and store employees. Outside employees include traveling salesmen, collectors, branch managers, purchasing agents, drivers, and the like. As an underwriting point of departure, inside risks are classified as preferred and outside risks as nonpreferred.

Outside risks are regarded as more hazardous than the inside because there is less immediate control. Again, outside employees are

frequently paid in whole or in part on a commission basis, and during a period of poor business there is a temptation to use more than is earned in anticipation of repaying out of future commissions.

Preferred risks are further classified. A salaried employee is preferred to one working on a commission plan of remuneration. Likewise, employees working for a firm of unquestioned financial standing and business integrity are preferred to those working for one of doubtful standing. Persons who have spent the greater part of their lives in a few positions are regarded as more dependable than those constantly on the move.

From an underwriting standpoint, the desirability of a schedule bond is measured by the proportion of preferred to nonpreferred classifications in the schedule. For example, a schedule with but one or two inside employees and a large number of outside employees would be very much less desirable than a schedule with the same number, but with the inside and outside situations reversed.

Necessity for Fidelity Bonds. Many employers are inclined to feel that a fidelity bond is not only unnecessary but an unfair reflection upon the integrity of faithful employees. This is likely to be the case in smaller organizations, where a personal contact is maintained between employees and owners. Generous and benevolent employers, frequently to their regret, have refused to require a bond because of the fullest confidence in the integrity of their employees.

Many losses are caused by employees who take funds without the intent to steal. When they use their employers' money for their own ends, they know the act to be wrong. Because they intend to return the money taken, they regard the act as technically wrong only, but not dishonest. In this class is the employee who takes money to invest in a business, to play the market, or to take a single flyer on a tip. More often than not such a person loses and, in an effort to extricate himself, takes more and more, until he becomes hopelessly entangled and confesses or is discovered. In adding up his loss, the employer finds small consolation in knowing that the dishonest employee intended to make restitution out of profits.

The less frequent loss caused by deliberate theft may be prompted by a desire to live a fast life. Sometimes the pace set by the group with which the employee has identified himself is more than he can keep. Rather than curtail, he becomes dishonest. Sometimes the employee breaks down morally, resorting to excessive drinking,

gambling, and other vices, and becomes involved financially with his employer before the discovery of his breakdown.

Advantages to the Employer. Aside from the fact that the fidelity bond provides indemnity to the employer in the event of a loss originating in a dishonest act of a bonded employee, there are other advantages. For example, bonding companies have machinery set up to investigate applicants for bonds, and the fact that a new employee passes the scrutiny of a bonding company saves the employer from much of the detail of making investigations of this type himself.

A second benefit is to be found in the moral effect upon the employee himself. Employees sometimes rely upon an appeal to the sympathies of their employers. Frequently such appeals are effective and, in the interests of sparing family, or connections, suffering caused by the defaulting employee, the case is adjusted. If the employee constantly has before him the fact that his reckoning must be made with an emotionally disinterested bonding company, this thought tends to act as a deterrent when temptation presents itself.

A final benefit from the standpoint of the employer is apparent when the loss does occur. To be obliged to deal with the employee and his family in the event of a defalcation is extremely distasteful and frequently the occasion of no little embarrassment. When a bond is provided, the employer is spared all such embarrassing and distasteful details.

Special Feature Bonds. Aside from the usual bond covering against loss caused by the dishonesty of an employee, there are a number of bonds classified in the fidelity group that have features peculiar to themselves. The automobile purchasers' embezzlement bond is a special coverage provided a retail automobile dealer to guarantee that he shall not suffer loss through the illegal disposal by the customer of a car bought on a time basis and not fully paid for. Likewise, bonds covering stock shortage are issued. Railway and express companies have special schedule forms drawn to fit the needs of their own businesses, and these the security companies are ordinarily willing to execute. It is the policy of security companies to write fidelity bonds where some peculiar feature of the risk requires a special form. Ordinarily such cases must be submitted to the company before the bond can be executed.

Selecting the Form. Individual bonds may be used, regardless of the number to be covered. In a large organization, the details in-

volved in keeping so many separate documents is sufficient reason for a move in the direction of greater simplicity. If more than a very few employees are to be bonded, either the schedule or the blanket form is preferable.

One of the drawbacks of the schedule form has been the necessity of notifying the company in the event of changes in the employees for whom coverage was desired. Under this form, moreover, coverage does not become effective until the company accepts the risk and issues a notice to this effect. Bonds, in some cases, may be written with an automatic coverage. When so written, changes added by the employer in the usual course are covered automatically for a period of ninety days until the company indicates its decision to accept or reject. The schedule form is considerably superior to a number of individual bonds. A final development is the blanket bond. In addition to the fidelity protection, blanket bonds have incorporated a wide range of other coverages. These bonds are highly technical and specialized documents, designed for particular classes of business. The more important of these forms will be noticed.

Primary and Excess Covers. A blanket bond covers employees within its scope in a lump sum. Thus, a bank may carry a bond for $25,000 on all its emloyees. The bank may feel that in a few cases the risk involved is considerably in excess of $25,000. The bond may be a very broad and expensive coverage. To protect itself adequately, rather than increase the coverage under this bond to $100,000, the bank will buy two bonds. The broad cover up to $25,000 will be carried, but with it a more limited and less expensive form for an additional $75,000. The effect is to supply a full cover for $25,000 and a cover, when required, up to $100,000. The bond supplying the broad basic cover is termed a "primary bond," and the second bond supplying more limited protection in larger amounts is termed an "excess cover."

Blanket Bonds for Financial Institutions. There are some twenty-four forms of blanket bonds designed to meet the needs of financial institutions. The figure, at first, would seem formidable, but many of the forms have become obsolete and are discontinued owing to the development of newer forms that have superseded them. In other instances the need for which a form has been devised has passed and therefore the bond is no longer in use. As a matter of actual fact, there are in general use but two forms for commercial

banks, a form for savings institutions, and two forms for building and loan associations. In addition, there are two forms in general use for private bankers and stock brokers, and a form for credit unions.

The adoption of the blanket bond idea was the outgrowth of a demand among bankers for a comprehensive protection designed to cover, not only the fidelity risks of the bank, but also other theft hazards, such as holdup, burglary, robbery, and the like. Prior to the development of the blanket bond, lending institutions were obliged to buy separate policies covering the fidelity of employees and the risk of burglary and robbery—both against the risk of loss on the premises and the in-transit risk of money and securities shipped or in the hands of messengers. Forgery coverages were purchased separately, as well as insurance protection involving safe deposit boxes. The chief concern of the officer responsible for placing insurance was always the possibility of leaving a "tendon of Achilles" in the form of an uninsured gap between coverages. Not of equally serious import, but serious enough, was the ever-present possibility of excess payment of premiums in the form of overlapping coverages. To meet the need of financial institutions for a complete and comprehensive coverage in a single contract, the blanket forms were developed. The first blanket forms drafted by American insurance companies appeared in 1915 and early 1916. The early forms were not regarded as sufficiently complete by lending institutions; but on June 8, 1916, a form was presented that was approved as adequate by the insurance committee of the American Bankers Association. Through the years the forms have been improved and revised with a view to continuously adapting the coverage to needs developed by changing conditions or evidenced by experience.

Forms No. 1 and No. 2.—The first of the forms in the bankers' blanket bond group to be developed became known as form "No. 1." It became popular at once and was widely used. However, steps were immediately taken to effect modifications, the outgrowth of demand and experience, to the end that form No. 1 early became obsolete. The original No. 1 bond in its present form covers the bank against: (*a*) loss of money or securities in which the bank has a pecuniary interest or held by the bank as bailee, trustee, or agent; (*b*) loss through a dishonest act of any officer or employee wherever committed; (*c*) loss through burglary, robbery, larceny, theft, holdup, or destruction while within any office covered, or within any recognized

place of safe deposit in the United States, or within any correspondent banks in the United States, or deposited with register or transfer agents in the United States in the usual course of business; (*d*) misplacement within offices covered or in the hands of correspondent banks, safe deposits, registrars, or transfer agents in the United States; (*e*) loss while in transit in the custody of an employee within fifty miles of bonded office in the United States or twenty miles of any bonded office elsewhere; (*f*) loss anywhere in the United States in transit while in the custody of an employee.

Form No. 1 bond is not now issued to new applicants, but it is of interest to note that it remains in its essentials the model for subsequent blanket forms. In place of form No. 1, form No. 2 is now used. It contains all the features that appeared originally in form No. 1, but it has modified the insuring clause better to meet the intent of all parties and has clarified certain of the clauses defining the liability of the surety. Form No. 2 has been repeatedly revised, and this form has until recently been one of the most widely used of all the blanket coverages.

Forms No. 8 (Revised) and No. 24.—Formerly, form No. 8 (revised) was the broadest form generally available to banking institutions. More recently form No. 24 was made available to large metropolitan banks. The cover under this form was broadened to meet the particular needs of large institutions. Form No. 24 is now available to all commercial banks, and although this coverage is somewhat broader than form No. 8 (revised), form No. 8 (revised), because of a premium differential, remained for a considerable time the most widely used of the bankers' blanket bonds for commercial institutions. More recent adjustments in the rates for the two forms have narrowed decidedly the difference in cost so that now form No. 24 is fast superseding form No. 8 (revised) and is generally preferred by bankers for the broad, comprehensive coverage it provides.

The bankers' blanket bond in form consists of three major divisions: (*a*) the insuring clauses which indicate the risks covered; (*b*) the exclusions indicating risks not insured or to what degree the coverages are modified; and (*c*) the discovery period which covers such features as notice requirements in event of loss, the reinstatement provisions, and the like. It is the intent of the bond to provide as complete coverage as possible against all risks due to criminal acts such as embezzlement, burglary, robbery, theft, larceny, and forgery.

The bond is not in actual fact an all-risks cover, in that, from an underwriting standpoint, it has not been found feasible to cover losses due to clerical errors, carelessness, and incompetence. The coverage, however, is very broad and is as near to an all-risks form as good insurance practice could devise. In addition to the hazards noted, the bond covers indemnity for loss of property through damage, destruction, misplacement, and mysterious disappearance. Property losses, when covered, are primarily losses associated with a criminal act such as, for example, property destroyed or lost through robbery, theft, burglary, or holdup. Misplacement and mysterious, unexplainable disappearances are covered even though there is no criminal implication.

Insuring Clauses: Indicative of the cover provided in the bankers' blanket bond, form No. 24 may be noted. There are four insuring clauses in the bond which indicate the classes of risk which the company is willing to assume. Insuring clause A is the fidelity coverage and provides protection against dishonest acts of employees. Insuring clause B provides the so-called "on premises" protection, insuring against loss caused by burglary, robbery, holdup, theft, larceny, misplacement or mysterious, unexplainable disappearance, and damage (except by fire) to the insured's offices, safes, vaults, equipment, or other property caused by larceny, theft, burglary, robbery, holdup, or any attempts thereat. Insuring clause C provides the "in-transit coverage" and provides insurance against losses due to larceny, robbery, holdup, misplacement or mysterious, unexplainable disappearance, damage or destruction, negligence of employees or of employees of armored motor-vehicle companies and provides a misplacement coverage for interim certificates, warrants, rights, and other securities. Insuring clause D provides a broad forgery coverage.

Exclusions: Exclusions vary with the form of the bond. Typical are losses due to hurricane, cyclone, tornado, earthquake, volcanic eruptions, or similar disturbances of nature. It is likewise customary to exclude losses from military, naval or usurped power, insurrection, riot, or civil commotion. The transit coverage of the policy applies in such instances, however, if, when the transit was initiated, there was no knowledge of such war risk or riot and civil commotion hazard on the part of any party who acted for the insured in initiating such transit. Some bonds cover transit losses due to outbreaks of

nature if the conditions laid down in the transit insurance clause are satisfied. It is also customary to exclude any loss recoverable from an armored motor-vehicle company, its insurer, or from any other insurance carried by the motor-vehicle company for its benefit. In other words, the bond covers only in excess of the amount that may be recovered from other insurance. It is also customary to exclude losses from customers' safe deposit boxes unless the loss is occasioned through the dishonest act of an employee under circumstances making the insured legally liable. The exclusions are generally limited, but each individual bond should be studied to determine the exclusions peculiar to that instrument.

Discovery Period: The final section of the bond has to do with the discovery period, notice requirements in the event of loss, and reinstatement provisions. It is usual to provide that losses must be discovered by the insured prior to the expiration of twelve months after termination or cancellation of the bond in its entirety. Requirements vary as to filing notice of loss, proof of claim, and suit for enforcing termination of the bonds. In the case of form No. 24, notice is required within a reasonable time after discovery, and proof of claim must be filed within 120 days after discovery. Twenty-four months is allowed as a period within which legal proceedings may be instituted.

Forms No. 4, 4A, 4B, and 4C.[1]—With the organization of the Federal Reserve banks and the superior facilities which they offered for holding securities, member banks and correspondents adopted the practice of sending large values in securities to be held in the vaults of these institutions. To provide protection for the Federal Reserve banks for property entrusted to them, blanket form No. 4 was offered. The form covered only property held in custody but not property of the Federal Reserve bank.

Since there was no obligation on the part of the Federal Reserve bank to provide this protection for property placed with it for safekeeping, the banks which owned the property began to make inquiry concerning a protection in which they themselves would have an

[1] Form No. 3 made its appearance to provide protection to the lending institution for loss to property in which it had a pecuniary interest or for which it was legally liable. This bond was designed primarily to provide protection for securities left with a bank for safekeeping by its customers. The bond is rarely used today, since the coverage it afforded was eventually incorporated in forms No. 1 and No. 2.

interest. Since they could not proceed against the bond of the Federal Reserve bank, application was made to surety companies for a protection to be issued directly to the owner of the deposited securities. To meet this need, form No. 4A was offered, providing protection to the property of a lending institution while in the custody of a Federal Reserve bank.

The development of the two foregoing forms brought to light the need for blanket protection for property held in the care of institutions other than Federal Reserve banks. To meet this need, form No. 4B was offered, under which protection was afforded whether the depository should be a Federal Reserve bank or some correspondent bank. This form afforded considerably broader protection than was to be found in No. 4A, and No. 4A therefore became obsolete.

It has already been noted that bankers' blanket bonds are issued only to designated classes of financial institutions. With the usefulness of the form No. 4B for financial institutions established, it became at once apparent that there were other large organizations owning substantial values in securities placed in the hands of banks for safekeeping that likewise had need of the same protection. To meet this need, form No. 4C was developed. The bond retains its position in the classification of a bankers' blanket bond in that it is issued to the financial institution with which the securities are deposited for safekeeping but is written "for the account of" the individual or corporation actually owning the securities.

Form No. 5 (Revised).—Form No. 5 was developed in the process of the evolution of bankers' blanket bonds to provide a broad coverage for savings banks. Since first offered, the form has been revised, but contrary to the precedent set in the case of previous revisions of other forms, a new number was not assigned to the revised form, so that the bond now available is known as form "No. 5 (revised)." This form is issued only to savings banks and covers dishonesty, burglary, robbery, holdup, theft, larceny, misplacement, damage and destruction on the insured's premises, and a transit coverage. The protection afforded is much the same as that offered under form No. 8 (revised), although because of its particular adaptation to savings institutions the coverage is broader than that under form No. 8. While the clauses of form No. 5 (revised) do not follow specifically those of form No. 8 (revised), the coverages are sufficiently similar to make further discussion of both forms unnecessary.

Forms No. 12 and No. 14 (Revised).[2]—Forms No. 12 and No. 14 (revised) are designed to meet the needs of investment bankers and stock brokers. The forms follow generally the plan of forms No. 2 and No. 8 (revised), but they are extremely flexible because a wide range of endorsements are available to adapt them to the particular needs of the insured. Form No. 12 is used for smaller risks. When comprehensive coverage is desired, form No. 14 (revised) with the endorsements required to adapt it to the risk is the form most generally used.

A feature of the coverage peculiar to brokers' bonds is to be found in the protection offered for losses sustained through security trades conducted by an employee in the name of the customer. Form No. 12 excludes the coverage, and formerly it was available under form No. 14 only by endorsement. The latest revision of form No. 14 covers trading losses as well as losses due to misplacement, abstraction, removal, and destruction. Forgery may be added by endorsement.

It is a condition of brokers' bonds that a complete audit be made annually by a certified public accountant, though this requirement may be eliminated by endorsement. Restoration on a retroactive basis is available by endorsement.

Forms No. 16 and No. 22.[3]—These two blanket forms are currently available for building and loan, and savings and loan associations. Form No. 16 (revised), known as the "building and loan blanket bond," was the first to appear for this type of institution. It represented an attempt to draft a form adapted to their particular needs. While forms No. 2 and No. 8 were early made available to these associations, the fact that many of these organizations are small and have limited staffs of salaried employees, and some have no sal-

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[2] Form No. 9 was devised for the use of the War Finance Corporation and is no longer written. Form No. 10 has a limited use because it applies to such institutions as Federal land banks and Federal land credit institutions. Form No. 11 provided a limited brokers' cover and is obsolete. Form No. 12 was a brokers' form and has been replaced by Form No. 14. Form No. 13 is obsolete.

[3] Form No. 15 was identical with form No. 14 except that no annual audit was required. With the revision of form No. 14, this form became obsolete. Form No. 17 was designed for the Federal Farm Board, and form No. 18 for the closed-bank section of the Reconstruction Finance Corporation. Form No. 19 is written for brokers who are not members of clearing houses and who clear through banks or other brokers. The form is now offered as form No. 19 (revised). Form No. 20 is used by the Federal Home Loan banks, and form No. 21 is written only for clearing houses and clearing associations and is known as the "bankers' and brokers' clearing house blanket bond." This form is still available, although it has been used but little.

aried employees at all, made the No. 2 and No. 8 forms poorly adapted to their needs. Form No. 16 included in the term "employee" attorneys, solicitors, or counsel elected or appointed by resolution of the board of directors. Under forms No. 2 and No. 8, directors were not included as employees, unless they were at the same time salaried officers. Under form No. 16, in performing acts to further the business of the institution they were classed as employees. The definition of property was likewise modified to meet the needs of building and loan associations. Since in many small associations lacking adequate vault or other protective facilities, officers and directors frequently carried property of the association to their homes or other places of business, burglary protection was extended to these additional locations.

Form No. 22, more recently offered, is known as the "savings and loan blanket bond" but is available as well for building and loan associations. This form is patterned after form No. 5 issued to savings banks but is adapted to the needs of savings and loan associations. The dishonesty coverage is considerably broader than that under form No. 16. Misplacement or mysterious, unexplainable disappearance is covered. A protection needed by this type of institution includes fidelity coverage on each person duly elected or appointed by the insured to collect rents. A special insuring clause is included covering persons appointed to make collections of savings from school children. It was noted that form No. 5 provided a broader coverage for savings banks than did form No. 8 (revised). Since form No. 22 is modeled after form No. 5 but adapted to the particular needs of savings and loan associations, this bond provides the broadest available protection for this type of institution.

Form No. 23.—This is known as the "credit union blanket bond" and has been prepared to meet the needs of both federalized and state incorporated credit unions. The bond, as in the case of savings and loan forms, contains a broad definition of employee. Not only are officers and clerks covered, but as well attorneys-at-law of the insured who have been elected or appointed by the board of trustees, members of credit or supervisory committees, and directors, and other persons in the immediate employ of the union. The bond provides fidelity coverage and the various on-the-premises theft coverages, such as losses originating in robbery, burglary, larceny, theft, and holdup. Misplacement and unexplainable, mysterious disappearance may be added by endorsement. The in-transit, robbery, burglary, larceny,

theft, or holdup cover applies. The form provides retroactive restoration after loss.

The Restoration Clause. There are two types of restoration clauses, and it is important to recognize the difference between them. Under one form, the bond is automatically reinstated to its full amount after a loss. However, the amount reinstated is effective only for future losses.

The most comprehensive restoration form is known as the "retroactive restoration clause" and is available for primary commercial blanket bonds and is also part of the coverage under certain of the bankers' blanket bonds. The retroactive restoration clause has the effect of automatically restoring the full face of the bond as to prior losses following the discovery of a dishonest or fraudulent act.

Under the simple restoration form, a bond covering $25,000 would automatically be reinstated as of the date of a loss to the full amount. A loss of $20,000 discovered on the first of the month would be covered in full. A loss that occurred in the previous month and discovered later would have only $5,000 coverage to apply. A loss that occurred in point of time subsequent to reinstatement would have the full amount of the bond to apply. Under the retroactive restoration cover, the situation is different. For example, if during any year a loss is discovered, the bond is reinstated in full. If a loss antedating the first loss is discovered later, that loss also is covered in full.

Covering Controlled Institutions. Under the rules governing the writing of the bankers' blanket bond, when a bank controls another through the ownership of over 50 per cent of the controlled institution's stock, the blanket bond of the parent institution may be extended to include the controlled bank on the same basis as a branch. This often results in a premium saving amounting to several thousand dollars annually.

From the point of view of the insurance company, this coverage is a simple matter. Occasionally, in some jurisdictions, technical difficulties have arisen as a result of the legal requirements of the state. This has made necessary the most careful wording of the bond and endorsements to make a single bond serve for more than one corporate entity and at the same time comply with statutory requirements.

Bank examiners have objected to the issuing of a bond to a parent institution which includes controlled banks as branches. Even

though the banks were fully insured, the subsidiary banks might be obliged to collect through the parent institution; and contingencies would arise which would make this procedure unsatisfactory. Where the law requires a minimum bond for every bank, such a coverage is not regarded as a strict compliance. The difficulty is overcome by naming each bank as an insured and using a form with automatic reinstatement as to future losses and retroactive as to prior losses. Each bank, then, as an insured may proceed directly against the company, and the losses of one bank do not affect the coverage of another.

Commercial Blanket Bonds. Commercial blanket bonds are issued to all classes of employers other than those eligible for the bankers' or brokers' forms. All natural persons may be bonded, with the exception of corporation directors of an employer corporation, when the director is not also an officer of the corporation. To be eligible for bonding under the blanket commercial form, the employee must be in the regular service of the employer and compensated by salary, wages, or commission. The employer must have the right at all times to govern and direct the employee. Brokers, factors, commission merchants, consignees, contractors, and like representatives are not bondable employees.

Employees are divided into three classes for rating. Class A includes executives, officials, and all employees who are a part of their regular duties handle or have custody of money, securities, or merchandise. Class B employees do not as a part of their regular duties handle or have custody of money, securities, or merchandise. Inside salesmen, messengers, filing clerks, stenographers, typists, porters, and the like comprise this group. Class C is made up of wage earners, including foremen, factory workers, mechanics, and laborers. Class C workers do not handle money in the course of their regular duties.

There are two forms of the commercial blanket bond. Form A covers all class A employees and may at the option of the employer include class B employees. Form AA is an excess blanket form written over an underlying fidelity suretyship. This underlying suretyship may be individual, schedule, position, or blanket position. Commercial blanket fidelity bonds are written in amounts of $25,000 or multiples thereof.

The commercial blanket bond provides a fidelity coverage and does not include the wide range of additional features found in the

bankers' forms. Commercial blanket bonds are automatically restored as to future losses only.

The requirement that commercial blanket bonds be written for a minimum of $25,000 has put them beyond the reach of smaller concerns. To meet the needs of the smaller organizations, the "baby" commercial blanket bond is offered. This is issued in penalties of $10,000, $15,000, $20,000, and $25,000 on not more than twenty employees, not including those in the class C classification.

A blanket position bond is issued in penalties of $2,500, or its multiples, with a limit at $20,000. There is no limit as to the number of employees who may be covered by such a bond. It is recommended for organizations with but a few class A or class B employees. Coverage on new employees is automatic without notice from the employer, and excess limits for particular employees may be provided. No reinstatement clause is necessary, for there is no reduction in amount when a loss occurs. This feature is peculiar to this bond.

Official Bonds. In this group are to be found those bonds required by law to be filed by persons elected or appointed to positions of public trust. The group is divided into (*a*) those bonds executed in favor of the United States government, termed "federal-official bonds," and (*b*) all other official bonds, to which underwriters apply the term "public-official bonds."

Federal-Official Bonds.—Federal-official bonds are those required of federal officials who have government property of any sort in their custody or control. For bonds in this category the federal government, in the ordinary course, supplies the form.

Some of the bonds covering federal employees are issued in a routine manner, and the risk in the ordinary course is not regarded as particularly great. On the other hand, certain of the federal bonds, from an underwriting standpoint, are regarded as hazardous. This is so because the responsibility of the surety is so extensive as to cover losses for which the principal is actually liable but which involve no element of dishonesty. An example of bonds to be found in this category are those issued for officers of the National Guard or Naval Militia. Frequently, material and equipment for which they are responsible under the bond is not at all times under their actual control, and they may be held responsible for losses to which they themselves did not contribute directly.

The following example will serve to indicate the extent of the liability of the surety under a federal form:

KNOW ALL MEN BY THESE PRESENTS, That we.....of
....., ..., ...
(Street and No.) (Town) (State)
as Principal, and....., as Surety, are held and firmly bound unto the United States of America, in its own right and/or as agent for, or trustee of the assets of, the.....as Obligee, in the full and just sum of.....
Dollars ($.....) lawful money of the United States for the payment of which, well and truly to be made, we bind ourselves, jointly and severally, our and each of our joint and several heirs, executors and administrators, successors and assigns, firmly by these presents.

Sealed with our seals and dated this.....day of....., in the year one thousand nine hundred and thirty.....

WHEREAS, the said Principal is an employee of.....
(Name of Principal's Employer)
and in the course of his employment from time to time has money and property belonging to said Obligee, or for which said Obligee is responsible as agent or trustee;

NOW, THEREFORE, THE CONDITION OF THE FOREGOING OBLIGATION IS SUCH THAT, if the said....., so long as his duties require the handling of funds and/or property belonging to said Obligee, or for which said Obligee is responsible as agent or trustee, shall correctly and faithfully account for and pay over any and all moneys, checks, drafts, and the like, which by virtue of his employment are now in his custody, control, and/or possession, or which shall hereafter come into his custody, control and/or possession, without loaning, using, depositing in bank or exchanging for other funds than as allowed by law, and shall faithfully keep and correctly and faithfully account for any and all property which, by virtue of his aforesaid employment is now in his custody, control and/or possession, or which shall hereafter come into his custody, control and/or possession without loaning, using, destroying, surrendering, delivering or selling than as allowed by law, then this obligation to be void and of no effect; otherwise to be and remain in full force and virtue. Witness: (As to Principal)

.....
(Name)
.....
(Street)
.....
(Town) (State)

.....(SEAL)
(Principal)

.....(CORPORATE)
(Surety) (SEAL)
By.....
Attest.....

.....
(Name)
.....
(Street)
.....
(Town) (State)

This bond executed at....., ...
(Town) (State)
The rate of premium on this bond is $.....per thousand per year.

The list of federal officials for which bonds are required is very long indeed. They are required in such established departments as the Patent Office, Pension Office, Treasury Department, War Department, Department of Commerce, Department of Justice, Department of Labor, Department of State, Post Office Department, and Customs Department. They are also required of employees of the various federal agencies, such as the Federal Housing Administration, Federal Crop Insurance Corporation, Federal Deposit Insurance Corporation, and the like. Bonds are written both in favor of the

United States government and to cover subordinate employees in favor of their superior officers.

In the case of employees of the federal government there is no statutory procedure for the termination of liability. Bond premiums are charged during the period of employment, and when employment terminates the bonding company is notified, and premium charges are no longer made. There is, however, no actual cancellation of the bond or termination of the liability thereunder.

Public-Official Bonds.—Public-official bonds are furnished by elected or appointed officials of states; townships; towns, cities, villages, and other municipalities; school districts; drainage and irrigation districts; road districts; and other political subdivisions of states or counties. In the public-official group are included tax collectors and their assistants; deputies and their subordinates; state, county, city, and town treasurers and their deputies; sheriffs and their deputies; constables; justices of the peace; clerks of court; notaries public; coroners; auditors; officers and employees of the public school system; officers and employees of charitable, reformatory, and penal institutions; treasurers and collectors appointed in connection with the operation of highways, turnpikes, and bridges; insurance commissioners; highway police; wardens; inspectors; and other such officers.

Public-official bonds are subdivided into two classifications: (*a*) statutory and (*b*) common law. The common-law category is sometimes referred to as the "nonstatutory form." Statutory bonds are those specifically required by a state law, local ordinance, charter, or bylaw. Bonds in the common-law category are not required by law but are those required by painstaking public officials or public bodies of the various officials and employees who occupy positions of trust. They are executed for the protection of the public.

Public-official bonds are also further subdivided into: (*a*) dishonesty forms and (*b*) faithful performance forms. Bonds in the first category, as the term would indicate, cover only those losses resulting from dishonesty. Bonds in the second category cover, in addition to dishonesty, failure to perform the legal duties of the office. Bonds in the second group, in effect, guarantee that the official not only will perform the duties of his office in accordance with law but will, as well, account for all monies received by him and will turn over to his successor all property and monies in his possession upon the termina-

tion of his duties. It is to be emphasized that where the obligation is imposed by law it cannot be voided or minimized by inserting clauses in the bond designed to make the liability less than that contemplated by the statute.

Because of the operation of the statutes, the responsibilities of the public official, and hence of the bonding company, extend to certain contingent liabilities. For example, public officials who handle money are, as a rule, held responsible for loss in the event that the bank in which the money is deposited should fail, unless they comply fully with all the statutes governing in the circumstances. It has also been generally held by the courts that the public official may be held responsible for loss of funds from any source. This could hold him responsible in the case of a loss caused by burglary or robbery, or for loss of money or securities from any other cause, such as damage or destruction by fire, explosion, flood, windstorm, or other perils. The bonding company is, therefore, interested in knowing the extent to which the public official protects these funds by burglary, robbery, messenger, and other hazard insurance because in most instances the amounts involved are so large that the loss, in the ordinary course, will be borne by the bonding company.

An official bond, once filed, covers for the full term of office, and the method of terminating liability is covered in the statute. Unless the statute in the jurisdiction provides otherwise, liability will continue throughout the term for which the officer was elected or appointed. Some states have a statutory provision under which cancellation of a public-official bond may be effected by serving notice or filing petition. This situation, however, is an exception to the usual rule.

FOR REVIEW

1. What is the purpose of the fidelity bond?
2. What, specifically, are the guarantees of a fidelity bond?
3. The Tenth National Bank has bonded all of its officers and other employees who have anything to do with the handling of money. A misplacement loss of $5,000 is discovered and traced to a janitor. The fidelity bond schedule does not include this employee, and the bank is able to recover only a small part of its loss. What form of fidelity protection would have covered the loss and why?
4. Blanket bonds are sometimes referred to as "dishonesty insurance." Why is this?
5. X is the treasurer of a savings bank and is bonded for $25,000. Defalcations

totaling $75,000, extending over a period of eight years, are discovered. In no one year would the loss exceed the penalty of the bond. The directors of the bank contend that the surety company is liable for the amount embezzled on the ground that each annual premium payment made the bond for each year a separate contract of indemnity, and that the surety company is, therefore, liable under its terms to make good the embezzlement for each separate year. In your opinion, how strong is the case of the bank, and how much may it collect?

6. A large defalcation at X bank, consisting of a series of thefts, is discovered five years after the first theft was committed. The defalcations began when a bank officer began to suffer losses in the stock market as a result of speculation. During the period covered by the defalcation the bank was a party to three mergers, and the fidelity bond had been dropped twice because the bond coverage had been absorbed in the instance of each merger by another company. Since fidelity bonds contain what is known as a "cut-off clause," how could the insured have been protected against losses discovered after the expiration of the time provided in the cut-off clause?
7. X is the treasurer of a commercial bank and is bonded in the sum of $25,000. A loss occurs amounting to $100,000. A former bookkeeper now deceased is involved, as are probably other members of the bookkeeping staff. The treasurer is suspected of collusion, but the officers of the bank are unable definitely to indentify each employee's actual responsibility for the shortage. What is the position of the bank where each employee concerned is specifically bonded?
8. Does the bankers' blanket bond cover the contents of safe deposit boxes leased by the bank to its customers?
9. X, an insured bank under a bankers' blanket bond, carries full protection against forgery. Over a number of years, experience shows the forgery loss to have been limited to a few small checks each year. The bank decides, therefore, to assume the risk of small losses and, at a considerable saving of premium, write the policy on $1,000 deductible forgery form. The bank asks your advice. What is your reply?
10. A bank carries $100,000 burglary and robbery coverage under a bankers' blanket bond. The bank keeps in its vaults $100,000 in negotiable securities. To effect additional coverage the bank makes provisions to keep these securities in safe deposit boxes and secure a safe-deposit policy in that amount. In the event of a burglary, the bank undertakes to collect its own loss in full before making the proceeds of the policy available to customers' losses. May the bank collect?
11. A trust company carries a bankers' blanket bond in the amount of $100,000. The bank is satisfied with this amount of security coverage but feels that the burglary and robbery risk is much greater. The bank wishes the burglary and robbery coverage in the amount of $1,000,000. How can this be written?
12. Insurance companies scrutinize with great care a new bond offered them by a "hold-over," that is, a public official who has been in office for a long period of time. Why?

13. Bonds issued on behalf of National Guard officers and officials of Naval Militia who are answerable for equipment are regarded as hazardous by insurance companies. Can you indicate the reason for this?
14. If a bond covers a public official for the "faithful performance of his duty," what coverage does the bond provide in addition to dishonesty?
15. B has never carried a bond on any of his employees but recently, startled by reports of losses, has determined to provide coverage on a position-schedule basis. Outline how a "discovery bond" would be of advantage to this employer.

CHAPTER XLI

JUDICIAL BONDS

CLASSIFICATION. All bonds filed in judicial proceedings are included within the category of judicial bonds. Judicial bonds are sometimes referred to as "court bonds," but this term is more commonly used to designate a particular class of judicial bonds.

The field is divided into two groups. Fiduciary bonds constitute the first group and include those bonds which guarantee the faithful performance of a trust administered under the supervision and jurisdiction of a court. The second group includes all those bonds required of litigants in a court action. This is the group to which the term "court bond" is usually applied.

The coverage afforded by each subdivision is quite different. Fiduciary bonds provide a guarantee that the principal will discharge his trust honestly and in accordance with the law. The coverage is broader than one strictly against dishonesty, since it covers also losses occasioned by negligence or lack of ability. Court bonds differ in that they are given in connection with litigation, and the obligation is the payment of money. Honesty, integrity, high standing, or ability have no effect in determining the obligation if the litigation is in the end decided against the principal. Since bonds of this class involve the payment of money, they are sometimes termed "monetary obligations."

Fiduciary bonds are of two classes: (*a*) probate bonds, and (*b*) fiduciary bonds other than probate. Probate bonds are those required by the various probate courts of those entrusted with the administration of estates of decedents or the management of the estates of incompetents or minors. The classification of fiduciaries other than probate embraces all those bonds required of fiduciaries appointed by courts other than probate, such as, for example, receivers, assignees, or trustees in bankruptcy.

Court bonds may be divided into numerous subclasses. One division distinguishes between bonds required in proceedings at law and those required in equity. Bonds filed in proceedings at law may be further classified as bonds to be filed in: (*a*) civil actions or (*b*) criminal actions.

Probate Bonds. The guarantee of a probate bond that the fiduciary will fulfill his trust in accordance with law involves numerous specific obligations, such as the filing of inventories, taking prompt steps to conserve assets, properly investing funds, and properly making distributions where so directed. In addition to the reputation of the principal for honesty, the surety company is interested that he have full knowledge of the responsibilities he assumes and the ability to fulfill the requirements of the trust.

Among the more frequently used probate bonds may be mentioned those required by an administrator, temporary administrator, special administrator, administrator to collect, ancillary administrator, administrator with the will annexed (*cum testamento annexo*), administrator d.b.n. (*de bonis non*), administrator to sell real estate, executor, guardian, guardian *ad litem,* conservator, and testamentary trustee.

When an individual dies without making a will, the person appointed by the court to administer the estate is termed an "administrator." Fiduciaries appointed to serve as administrators temporarily, pending the making of a permanent appointment, are termed "temporary" or "special administrators." Sometimes an appointment is made for the purpose of collecting and preserving perishables, pending the initiation of a permanent administration, and such an appointee is known as an "administrator to collect." An "ancillary administrator" is a fiduciary subordinate to the general administrator. An administrator with will annexed is appointed when the decedent has made a will without naming an executor, or the executor is unable or unwilling to serve. An administrator d.b.n. is appointed when the general administrator first appointed has, because of death, resignation, or removal, been unable fully to complete the administration. An administrator ordinarily has no right to sell the real estate of an estate, and where such a step is necessary to pay the debts of the estate, a court order is required. In connection with the granting of authority to sell, a bond of an administrator to sell real estate must be filed.

If a will names a person to carry out the instructions of the deceased as set forth in the will, the person so designated is termed an "executor." A person designated by the court to manage the estate of a minor is termed a "guardian." Sometimes the term is applied to a fiduciary appointed to handle the estate of an adult incompetent,

though in this case the term "conservator" is more usual. A guardian *ad litem* is appointed to represent a minor or incompetent in some litigation in which he has or may have an interest. A testamentary trustee is appointed under the terms of a will to carry out the terms of a trust created in the instrument. Such a trustee may be the executor, or he may be another person.

Joint Control. Because of the nature of the guarantee under a probate bond, surety companies are not always willing to assume the risk without retaining for themselves some control over the direction and management of the estate. This has given rise to the writing of bonds under a plan of joint control. Under the plan, a special joint-control agreement is executed at the time application for the bond is made.

When the principal and surety agree to joint control, the principal is required to deposit all funds belonging to the estate in a bank under the name of the estate. Checks then may be drawn on this account by the fiduciary, but before presentment for payment they must be countersigned by a representative of the bonding company. A similar procedure is followed in the event that there are funds deposited in a savings bank. After the agreement is made, arrangements are made with the bank that no withdrawals are to be allowed unless a withdrawal slip is countersigned by the bonding company consenting thereto. If the savings bank is unwilling to consent to such an arrangement, joint control is sometimes arranged by placing the bank book in a safety-deposit box and arrangement made for joint control of the box. When securities are involved, they are to be kept in a safety-deposit box in the name of the estate and arrangements are made so that access to the box may be had only in the presence of a representative of the surety company.

Applicants for fidelity bonds frequently resent the request of surety companies for joint control. There is a tendency on the part of those not fully informed to feel that such a request in some way carries a reflection upon their honesty. A careful scrutiny of the entire problem will show the case to be otherwise. The obligations placed by law upon the fiduciary are not always simple matters to those unacquainted with the duties of the position to which they have been appointed. A fiduciary, by some improper act, though committed with the best intention, or by the failure to act through carelessness or inadvertence, may bring upon himself huge personal

losses. Through co-operating with a surety company and permitting the exercise of joint control, the fiduciary has nothing whatever to lose and stands in a position to gain through the experience and wide knowledge of company representatives. Obviously, persons are sometimes named in a fiduciary capacity, and this is particularly so in the case of executors, who, having no experience or training in the duties of a fiduciary, are entirely incompetent to act without some guidance or direction. In such cases joint control is absolutely essential. On the other hand, it often happens that persons of wealth and wide experience are appointed to such positions. These persons are in the habit of making available to themselves the best legal advice. In such cases joint control may sometimes be waived by the surety company.

Sometimes in large estates, as a means of simplifying the handling of detail, a special account, termed a "free-working account," is set up. This account is not subject to the joint control, but is supplied with funds from time to time from a joint-control account. Otherwise, the balance of the estate is subject to joint control. It is a policy of surety companies never to waive entirely joint control on the basis of the excellence of the reputation and the standing of the fiduciary in the community. Sometimes, however, circumstances are such that joint control is not absolutely essential. This is the case when the estate is small or when it is in such shape that a final distribution will be promptly made under the direction and advice of a competent attorney.

Special Probate Bonds. Frequently in probate affairs, bonds are required that are essentially financial guarantees. Such a bond is a "refunding bond." If a beneficiary or heir desires to receive all or part of his share of the estate before distribution may properly be made by the administrator or executor, the fiduciary will require a surety bond to protect him from loss. Sometimes, when personal property is insufficient to pay the debts of the deceased, and the heirs wish to save the real estate from sale, they may file a bond guaranteeing the payment of the debts. On the other hand, heirs who may wish to sell real estate before the estate has been settled are required by the purchaser to file a bond guaranteeing him against loss if the personal property proves insufficient to meet the decedent's debts.

Premium on Probate Bonds. The premium on probate bonds is computed by applying the manual rate to the penalty of the bond.

Rates are quoted on a sliding scale, subject to an annual minimum premium.

If the bond is to run for a period longer than a year, the renewal premium for all years subsequent to the first is 80 per cent of the first year's premium. If the penalty of the bond is equal to or greater than twice the assets of the estate, the first year's premium is subject to a 20 per cent discount and subsequent premiums, as before, are 80 per cent of the first year's premium.

When it is evident from the outset that the period of the trust is to continue for a number of years, discounts may be allowed for the advance payment of future annual renewals. The following discounts may be taken:

	Discount
Advance payment of 1 annual renewal	None
Advance payment of 2 annual renewals	10%
Advance payment of 3 annual renewals	10%
Advance payment of 4 annual renewals	12%
Advance payment of 5 annual renewals	15%
Advance payment of 6 annual renewals	18%
Advance payment of 7 annual renewals	21%
Advance payment of 8 annual renewals	24%
Advance payment of 9 annual renewals	27%
Advance payment of 10 or more annual renewals	30%

Since the first annual premium is payable in advance in any case, this premium may not be included as an advance payment for the purpose of computing a discount.

Unearned Premiums. If the trust is fulfilled or the estate closed within a year, the first year's premium is held to have been fully earned by the company, and no refund is payable. If the bond is renewed and later canceled, a pro rata refund may be made from the renewal premium.

The rules provide than when a new bond is given for the same person as an earlier bond, and the new appointment extinguishes the duties of the earlier appointment, the first bond may be canceled at the date of the new bond with a pro rata return premium to be applied on the new bond. If the new appointment does not extinguish the earlier appointment, the premium on the earlier bond runs until the bond is discharged by a lawful accounting. A pro rata return premium is then due. If the new appointee is a different person from the former fiduciary, the earlier bond may be canceled with a pro

rata return of premium only after the first fiduciary has made a proper accounting.

When advance renewal premiums have been paid for the purpose of securing a discount, and the bond is discharged before the termination of the period for which advance premiums have been paid, the premium is computed allowing such discounts as apply for the period the bond has actually been in force, and the difference between this premium and the premium actually paid in advance represents the amount of the return premium to be refunded.

Fiduciaries Other than Probate. Into this classification fall fiduciaries appointed in the district, county, circuit, and state courts, other than probate. They are appointed to handle an estate or to manage a business when there are a number of conflicting interests and an impartial person in charge will safeguard the interests of all and ultimately effect an equitable distribution of assets.

In this group are to be found: (*a*) conservators, trustees, custodians, or others, under whatever title, appointed to conserve the assets of closed state or national banks; (*b*) receivers or liquidators of closed state banks or building and loan associations: (*c*) receivers appointed in all state courts and receivers in federal courts; (*d*) assignees or trustees for the benefit of creditors, under state laws; (*e*) masters, referees, trustees, or commissioners, for the sale of real estate or other property, in partition, foreclosure, reorganization, or winding up proceedings, or other litigation where the duties do not require conservation or investment of assets or any duties of administration other than a sale with the distribution of the proceeds; (*f*) receivers, trustees, liquidators, or others managing or liquidating property on which mortgages are in default; (*g*) receivers or trustees in bankruptcy appointed solely to close the business, marshal the assets, and distribute pro rata to creditors; (*h*) custodians, receivers, or trustees, whether temporary or permanent, authorized or empowered to conduct a business as a going concern, for any period pending reorganization under the 1933 Amendments to the Federal Bankruptcy Act or the Corporate Bankruptcy Act of 1934.

Rates for computing the premium in this group are quoted at a flat amount per thousand dollars' penalty of the bond. In some cases the rate is on a sliding scale, decreasing as the amount of the bond increases, and in other cases the rate remains the same per thousand regardless of the amount of the bond. In the case of

masters, referees, and commissioners, a special rate is allowed when a large number of bonds are written for the same person in a single month. An annual minimum premium is required in every case, and the first year's premium is considered earned.

Monetary Obligations. This category includes all bonds filed in behalf of litigants in connection with judicial proceedings in the courts. The bond finds its usefulness in permitting the principal thereunder to maintain an action when damages are required if the action is unsuccessful, and when the court requires a surety to protect the other party from loss in the event that the action brought is unsuccessful. Liability under the bond, therefore, is not contingent upon the honesty of the principal or his ability to fulfill a trust. The obligation assumed by the bonding company is the payment of money in the event that the action brought, for which the bond is given, comes to an unfavorable termination from the point of view of the principal. It is this feature of the bond that gives rise to the term "monetary obligation."

Plaintiffs' Bonds. A creditor, living outside the state in which he brings an action against a debtor to recover, is required to file a bond guaranteeing the payment of the costs of the suit. In the event that property of a defendant is held as a means for satisfying a claim if the action is successful, the plaintiff will be required to file a bond guaranteeing the defendant against loss through having his property so tied up. Again, if a plaintiff undertakes to compel a defendant to do or refrain from doing certain things, a bond is required to save the defendant against loss if the plaintiff is unsuccessful in sustaining his position. Bonds of this type are termed "plaintiffs' bonds."

Since the action in such cases is initiated by the plaintiff and the bond is given by him so that he may proceed with his action, such bonds are termed by underwriters "voluntary bonds."

Defendants' Bonds. It often happens that because of the nature of the action it is necessary or convenient for the defendant to file a bond. For example, when property has been tied up pending the outcome of an action, the defendant may release the property and secure to himself the use of it by filing a bond. Again, when the court has ordered a defendant temporarily to refrain from some action, unless unusual features make the procedure inequitable, the defendent may be permitted to proceed with the act enjoined by filing a bond to indemnify the plaintiff if the case is decided against the defendant.

Bonds in this category are termed "compulsory bonds," since the defendant is obliged to file the bond if he would protect his position or continue the action in his own interest.

Nature of the Penalty. There are two classes of bonds with reference to the amount of the obligation, known respectively as "fixed penalty bonds" and "open penalty bonds."

If the penalty of the bond can be determined in advance as a fixed amount, the bond is classed as a fixed penalty bond. The group includes any bond filed to enable plaintiff or defendant to pursue the remedy of the courts, or staying or guaranteeing the payment of any recovery or relief. Among the more commonly used fixed penalty bonds are those used in the case of adjournment or postponement of trial, attachment (plaintiff's bond), condemnation of land, costs, discharge of injunction, *ex parte* application for receivership, execution, garnishment, injunction, mandamus, petitioning creditors, release, stay of proceedings, writ of distress or writ of distraint, and writ of error or prohibition.

Bonds in which the amount of the liability is not fixed but is dependent upon the outcome of the action are classed as open penalty bonds. Included in the group are cost, appeal, discharge of attachment, discharge of mechanics' lien, release of garnishment, writ of distress, or writ of distraint bonds.

Collateral Requirement. Since the principal on a court bond, if the case is decided against him, is liable for damages suffered by the party opposing him in his action, and the obligation of the bond is the payment of money, the surety will undertake to satisfy itself that if unsuccessful the principal is in a position to meet his obligation.

Surety companies regard bonds of this class as particularly hazardous. Unless the applicant for such a bond is in a strong financial position and his ability to pay beyond doubt, the company asked to be surety will require that the bond be fully secured by suitable collateral.

The question is sometimes asked how a surety company in supplying a bond can justify charging a premium for the bond and at the same time secure itself against any possibility of loss by requiring the deposit of full collateral to cover the risk. A comparison is made between the procedure of a bank and that followed by a surety company. The bank lends money and charges interest, yet only in unusual cases

in which the borrower's position is particularly strong will the bank lend without the deposit of collateral to secure the loan. So with the bonding company. By supplying a bond for a court action, the surety company lends its credit, which is closely akin to money, and will therefore waive the requirement for collateral only under conditions much the same as those warranting a bank to lend on an unsecured note. Bonds executed in behalf of plaintiffs are regarded by underwriters as less hazardous than those issued for defendants, and for this reason companies have a tendency to be more lenient with their collateral requirements for bonds of the voluntary or plaintiff group.

Frequently Used Forms. The use of certain of the bonds of the monetary obligation group is a matter of everyday routine in the courts. Some of the more widely used forms include:

a) Attachment Bonds.—This type of bond is issued on behalf of the plaintiff when provisional seizure is made of the defendant's property which is held by the sheriff as security for the payment of any judgment obtained. If the plaintiff loses his case, the bond protects the defendant for damages sustained as a result of the action.

b) Discharge of Attachment Bonds.—These bonds are filed to make possible the release of attached property. They are filed by a defendant and are regarded as extremely hazardous from an underwriting standpoint.

c) Injunction Bonds.—When one party wishes to prevent another from doing a certain act or following a certain procedure claimed to be inequitable, he may appeal to a chancery court for a restraining order or injunction. Pending a final hearing, the plaintiff must file a bond to indemnify the defendant if the case is not sustained.

d) Replevin Bonds.—An action to secure possession of personal property by its alleged owner is instituted by filing a replevin suit. The question of title is settled by the suit, but in the meantime the defendant is deprived of the possession of the property in question. This is a plaintiff's bond to indemnify the defendant if the suit is decided in his favor.

e) Bonds Given to Sheriff or Marshal.—These bonds guarantee to protect the sheriff or marshal to whom they are given against damage suits growing out of the seizure of property.

f) Appeal Bonds.—If an unsuccessful litigant desires to appeal his case to a higher court, he is required to file a bond in the court from

which the appeal is taken. The bond guarantees payment of the judgment, plus interest and cost, if the appeal is not maintained successfully.

g) *Bail Bonds.*—These bonds are given to secure the release of an individual who is under arrest. The bond guarantees that the person released will appear when required by the court, and in the event of his failure to appear, the amount of the bond is forfeited.

Sufficient examples are here given to indicate the nature of court bonds. The bonds used in other court actions are in principle essentially the same as those in one or the other of the examples mentioned.

Premium on Court Bonds. Rates for court bonds are quoted at a flat premium per thousand dollars of bond penalty; or, if the bond is given without penalty, the amount of the judgment or claim or the value of the property or other matter in controversy is used to compute the premium. All bonds are subject to a stipulated minimum charge.

Court bonds which carry annual premiums charge renewals on the anniversary date of the bond at the same rate as the first premium. If the bond is canceled, the first year's premium is considered fully earned, except in certain cases when a bond in preliminary proceedings has been made permanent or when a bond has been given to stay execution of judgment pending permission to appeal, in which case within six months a new bond on appeal is required. In the exceptions noted, a premium adjustment is allowed. When the bond is canceled after the termination of the first year, a pro rata refund is allowable from the renewal premium, subject to the requirement that an amount equal to the annual minimum shall be retained by the company.

FOR REVIEW

1. The automobile of X is involved in an accident in a community in which X is a stranger. Claim is immediately filed against X by the other party to the accident, who attaches X's car. X wishes to proceed about his business and intends to dispute the claim in court. How may he get his automobile?
2. What is meant by the term "litigation bonds"?
3. Probate bonds are required when a person is appointed by the court to safeguard the estate of an incompetent. Indicate cases in which a court will make such an appointment.
4. Distinguish between a receiver's bond and trustee's bond in bankruptcy action.

5. Define the duties of a receiver in equity in a state court. In the case of the receiver in equity, what is the attitude of the bonding company with regard to joint control?
6. Why, if joint control is desirable in the case of a probate bond, is it not likewise required in the case of a receiver or trustee in bankruptcy?
7. X has filed a receiver's bond, and Y a trustee's bond in connection with the bankrupt estate of A. After A's discharge by the court, the sureties on the bonds are asking to be released. Will the court grant their request?
8. What is the attitude of a surety company toward writing a bail bond?
9. The father of X died without making a will. X is appointed administrator by the probate court and is required to file a surety bond. The surety company insists upon joint control, and this X bitterly resents as he feels it to be a reflection upon his honesty. Explain to X that this is not a reflection upon his honesty, and explain the reason for joint control.
10. In the case of involuntary proceedings in bankruptcy arising when application is made by thirty-six creditors, what bond must the participating creditors file?
11. A probate bond guarantees in substance that the fiduciary will fulfill his trust in accordance with the law under which he has been appointed. What are some of his obligations?
12. Frequently in probate cases the surety requires, as a condition for writing the bonds, that it exercise joint control with the fiduciary. When this suggestion is made to the fiduciary he sometimes evidences resentment as a reflection upon his honesty. Discuss.

CHAPTER XLII

CONTRACT BONDS

THE Performance of a Contract. Text writers in the field of law briefly define a contract as "an agreement enforceable by law." The agreement must have a legal object and be made between two or more competent persons who agree to do or not to do certain specified acts.

For any breach of the terms or conditions of a contract, regardless of how apparently unimportant the violation may seem, relief to the injured party is provided by law. This relief may take the form of damages, or, if the breach is of material consequence, the injured party may demand a rescission of the agreement. There is also a remedy available in equity when the contract is of such a nature that damages will not provide adequate compensation. This remedy is termed "specific performance" and may be demanded when the contract calls for the delivery of some property having peculiar or intrinsic value.

Failure by the party under obligation to perform, or to comply with the terms and conditions of a contract, results in most cases in an action for damages. The amount of damage the injured party is entitled to receive is, as a final resort, determined by a jury. The jury is obligated to consider the evidence and fix an amount that will, so far as possible, put the injured person in the position he would have enjoyed but for the breach.

If failure to perform is due to inability, lack of resources, or like cause, the injured person may find himself appealing for damages to a bankrupt. It is not an easy thing in a sizable operation to go into the field and secure on advantageous terms the services of a contractor to take over the partly finished work of another who has failed in his undertaking.

So that the parties letting a contract may be relieved of the necessity of ever facing such a situation, the contract bond has been devised. Under its terms the contractor, as the principal, and the surety company, as surety, undertake that the contractor shall perform his obligations under the contract, provided always that the

other party to the contract (the obligee) makes payments as agreed and otherwise fulfills his part of the agreement.

While contract bonds are by no means limited to government work, the practice of federal, state, and political subdivisions of requiring contract bonds, in connection with work performed, has tended to associate the necessity for a surety bond with all government contracting. With the inauguration of the vast defense program, followed by the increase in government contract work after the declaration of war with Japan, Germany, and Italy, contract bonding assumed an important place in the business activity of the nation.

Contract Bonds Classified. There are four main classes of contract bonds as follows: (1) construction, (2) supply, (3) maintenance, and (4) miscellaneous.

Under the first heading are to be found bonds such as those guaranteeing construction where the work contracted for on completion becomes attached to, or forms part of, the real property. Supply contract bonds guarantee a supply of material contracted for at an agreed price. A newspaper publisher might require such a bond in connection with a term contract for its supply of newsprint. Maintenance bonds are given in connection with contracts undertaking to maintain all or part of the work in good condition for a term after completion. An example is to be found in the agreement frequently inserted in construction contracts that the roof will be maintained in condition during a period of years. The purpose of such a bond is, in effect, to provide a guarantee against defective materials or workmanship, though sometimes the obligation extends to include efficient and successful operation for a term of years. The miscellaneous group includes a wide variety of bonds not classified under one of the other headings, such as a compensation bond of a self-insurer under a workmen's compensation act, and the bond of a lessee guaranteeing to make certain improvements to the property leased or guaranteeing the payment of the rent during the term of the lease.

Construction Contract Bonds. Contractors undertaking the construction of public works or public buildings are, as a rule, required by law to furnish a bond. The advantages of surety bond in guaranteeing the faithful performance of the contract have proved attractive to private enterprise, so that this type of bond is also widely used in connection with private undertakings.

The guarantee under a construction bond obligates the surety to

indemnify the owner in the event that the contractor fails to complete the undertaking. To make the owner whole in the event of default on the part of the contractor, the surety is faced with the choice of undertaking to finish the work and pay any difference in cost occasioned by the change or of allowing the owner to proceed with the work to completion and reimbursing him for the cost in excess of the original contract price.

In addition to the foregoing, most contract bonds, particularly in the case of public contracts, guarantee that the contractor will pay all labor and material bills incurred. The surety is likewise required to indemnify the owners for loss occasioned by injury either to employees or to the public. This risk is, of course, usually insured by the contractor under the proper public liability and workmen's compensation forms.

Some element of maintenance may be incorporated in construction contracts and, when so incorporated, forms part of the risk covered by the bond. This element is usually limited to a guarantee to the owner that he will suffer no loss through incompetent workmanship or the use of defective materials. The time for the discovery of defects is limited ordinarily to a year. Surety underwriters scrutinize construction contracts carefully to determine the extent of the maintenance risk.

The Financial Statement. Basically, the contract bond is a guarantee not only of the honesty of the contractor and his ability to do the work but also a guarantee of his financial strength. Because of the financial obligation which the surety assumes, a carefully prepared financial statement is required of each applicant for a bond. Not only is the reputation of the applicant for honesty, ability, and experience carefully scrutinized, but also his financial statement is regarded as a factor of major importance in determining whether or not the bond is acceptable to the company.

Surety underwriters require that entries made in the statement be accompanied by sufficient data to permit verification. In connection with the item, "cash in bank," the names of the institutions carrying deposits are required. In checking the figure, the surety company will go farther than to see that the figure was correct as of the day of the statement. The company is interested in knowing the average balance of the applicant over a period of months, his indebtedness to the bank, how it is secured, and the additional credit and terms the

bank will extend. Cash in the office is regarded with suspicion if the amount is large, unless there is some reason indicated for withholding the amount from deposit. Verification of such amounts by actual count will be required.

Stocks and bonds, when included as assets, must be listed in detail, showing the number of shares or bonds owned, the name of the issuing corporation, and the market value. A surety company following approved underwriting practices will discount from the statement all securities of speculative nature or those having a slow or uncertain market. The surety underwriter will verify all prices quoted on securities listed to discover any tendency to inflate values.

Real estate is another item very carefully scrutinized. A natural tendency to assign a high value to one's own possessions and the desire to make as good a showing on the statement as possible sometimes prompt the applicant, frequently quite unconsciously, to inflate the value of real estate items. Since, in the long run, a conservative statement reflects to the credit of the applicant, while an inflated statement tends to discredit him, it is the part of wisdom to be conservative. It is almost certain that the surety company will check the date of purchase and the price paid, if of recent purchase, and will in any case get an opinion of value from a bank or real estate company. Real estate owned by a wife or other member of the family who is not a party to the agreement is not an admissible asset, nor is an undivided interest because of the time element necessary for liquidation.

Accounts receivable should be "clean." This means that uncollectibles should be charged off and that only accounts actually due and receivable be listed. Payments due on uncompleted contracts frequently represent nothing more than anticipated profits to accrue when an uncompleted job is finished. Such an item is not a due receivable and may not be listed as an asset.

Notes receivable are not regarded with favor as an asset by underwriters, unless there is some special notation concerning the item to indicate the notes listed to be exceptions to the general rule. Most notes in the hands of contractors are taken because the account is otherwise uncollectible and, therefore, give little promise of assistance should the need quickly arise.

Items listed by contractors under plant and equipment are subject to heavy discounts by the underwriters. The condition of each item is of particular interest, as well as whether it is fully paid for. In cases

where liquidation has been necessary, the plant has rarely brought over 25 per cent of the value entered by the contractor in his statement, and frequently the amount realized has been much less.

Stocks of supplies, when listed as assets, must be limited to new and readily usable items. Old lumber, brick, or salvaged material is not acceptable as an asset. Because of the tendency of contractors to list such items, some underwriters discount entirely stock values for underwriting purposes, while others verify the figures and if satisfactory admit them.

The same careful scrutiny is given to liabilities. The surety company wants to know the extent of the applicant's borrowings. Particularly, it wants to know specifically which stocks and bonds, if any, have been hypothecated for loans and specifically any outstanding mortgages on the real estate. If the contractor's securities are not available for future loans or if the real estate is encumbered, even though the contractor's equity is substantial, the usefulness of this equity as an asset is materially lessened.

With further reference to loans, both secured and unsecured, the company is interested in knowing the dates when all such items are due. All loans made through banks are verified, and an expression is secured from the bank as to its willingness to consent to an extension. Notes payable to others than a bank are carefully checked, and when they are found to have been given to supply dealers for material, or to subcontractors, the risk from an underwriting standpoint is considerably less than satisfactory.

In the case of accounts payable, verification of the contractor's figures are not as easy as in the case of receivables. The surety company in making a check will invariably question dealers in the community other than those listed as creditors of the contractor. To find important accounts omitted from the liability statement will not enhance the standing of the applicant with the surety company.

The financial statement as presented by the contractor is reduced to a statement for underwriting purposes by adding only such assets as have an immediate liquidating value at a forced sale. Intangible items, such as goodwill, are entirely eliminated, and all other items reduced to a forced liquidating figure. From the sum so obtained, all liabilities are deducted, and the balance is the contractor's underwriting net worth.

Contractors who have been refused bonds have sometimes felt

themselves to be unjustly treated. In their own eyes their statements have been entirely adequate. Since it is the underwriters that make the rules, and since they are primarily interested in quickly convertible assets, a contractor will find it to his advantage to familiarize himself with surety company requirements and adjust a sufficient proportion of his investments accordingly.

Other Work. It frequently happens that bonds are refused when the financial statement as presented by an applicant shows resources entirely adequate for the contract. The cause of rejection is to be found in the amount of unfinished work on hand. Since the applicant may be obligated to undertake or complete other work, bonding companies require a statement showing the status of all partially completed contracts. In this statement must also be included a statement of all contracts upon which bids have been filed, together with a statement of the amount of the bid and the nature and location of the work.

Dangerous and Unfamiliar Work. Bonding companies know that ambitious contractors, who have been successful in a small way, are frequently tempted to assume excessive liabilities. Should a contractor with a successful experience in a specific field suddenly undertake a sizable operation in a field in which he has no background of experience, particularly if it is a highly specialized field, then, regardless of a previous good record, a careful underwriter would accept the risk only under unusual circumstances.

Another situation is presented when the undertaking is classed as inherently dangerous. A slight accident frequently results in disastrous consequences. Difficulties not anticipated when the work was undertaken may involve a tremendous and entirely unforeseen outlay. Tunnels, dams, and large bridges are in the category of dangerous undertakings, and before a bond is issued in connection with such undertakings, the company must be assured that the financial resources of the applicant are entirely adequate to meet a severe setback occasioned by the intervention of an unanticipated contingency.

Adequacy of Bid. A surety company before writing a contract bond will undertake to satisfy itself that the contractor is to secure adequate remuneration for his undertaking. It may be anticipated that the successful bidder for a construction job will be the lowest bidder, though this need not necessarily be the case. The surety company is interested in knowing how near the bid of the applicant

is to the "bunch." When there are a considerable number of bidders on a single job, one or more may be extremely high and one or more may be very low. Most of the bids will be reasonably close, and the bids that cluster together form the bunch. Since the figures of all contractors are computed independently, one serves as a check on the other, and any figure within or near the bunch may be assumed to be adequate. A variation of as much as 10 per cent from the next bidder would be considered an excessive spread and probably would be indicative of an error in calculation rather than an economy in operation.

Bid Bonds. Bid bonds, sometimes termed "proposal bonds," form an important subdivision of the construction and supply contract group. Bid bonds are filed before the contract is awarded and usually accompany the bid. The purpose of the bid bond is to guarantee that the contractor bidding, if he is awarded the contract, will sign the contract, supply such bond as is required, and proceed to carry on the work to a satisfactory conclusion.

Bid bonds fall into three main groups. Under the first type, if the contractor should fail to sign the contract and furnish a satisfactory final bond, the surety would be liable for any additional cost to the owner because of his being obliged to relet the contract. A second type of proposal obligation is known as a "bid letter," "surety's consent," or "surety's agreement." This is a communication addressed to the owner by the surety company, in which the company agrees to execute the final contract bond if the bidder named therein is awarded the contract. The third type of proposal bond is known as an "automatic bid bond," and in itself operates as the final bond if the bidder is successful and is awarded the contract.

Frequently owners offer to bidders the option of filing either a bid bond or a certified check. The amount of the bond or check is usually placed at about 5 to 10 per cent of the contract price. In the case of automatic bonds, the face will equal that required in the case of final bonds.

Mortgagors' Completion Bonds. By the terms of this bond, the surety guarantees the lender of money that the owner will complete the building described in a contract in accordance with its terms and deliver it free of liens. Bonds of this class are, strictly speaking, not contract bonds, but are noticed at this point because they find their use in connection with the financing of construction projects.

The construction contract bond guarantees that if the owner keeps his part of the agreement, which among other things is to make payments to the contractor as they become due, the contractor will faithfully complete the work. A failure to make payments when due relieves the contractor of the obligation to finish, and there is no obligation on the part of the bonding company on the contractor's construction bond to proceed with the work, since there has been no default by the contractor. A bank or other lender, in such circumstances, might find a partially completed building on its hands heavily encumbered with liens. To obviate any such happening, the completion bond is written.

The completion bond is given by the owner, not the contractor, to the lender of money. It guarantees to the lender that the borrower will fulfill his part of the lending agreement and his obligations to the construction contractor to the end that no act or default of the borrower, who is the owner of the property, will give grounds for failure on the part of the contractor to complete the building.

Relationship of Bid, Final, and Completion Bonds. A brief illustration will indicate the use of each of the three bonds mentioned in a construction operation. Assume a group of persons with a valuable piece of land and a sum of money. They decided to erect a hotel but need $200,000 more funds to use their land profitably. They bring their plans to a group of investment bankers, together with an estimated operating statement. The bankers feel that an issue of first mortgage bonds will sell readily but wish to be assured that the building costs will remain within estimates and that a completed and unencumbered building will be available as security for the mortgage.

The promoters of the hotel enterprise, when they advertise for bids, will require a bid bond of all bidders. This will guarantee that the successful bidder will undertake the work or indemnify the owners for any loss occasioned by his failure to do so. When the job is let, the contractor will furnish the owners a construction bond, which guarantees that the contractor will fulfill the terms and conditions of the agreement. The lenders of the money will require of the owners of the property, who are the borrowers, a completion bond, which guarantees that they will administer the funds in the manner agreed and advance their own share so that the building will, in fact, be completed unencumbered by liens.

There is no confusion of risks assumed by the different bonds and,

in order that the lender be completely protected from the beginning of the negotiations to the completion of the transaction, all three bonds or their equivalents are essential.

Supply Contract Bonds. As the term indicates, a "supply contract" is an agreement to furnish and deliver supplies; but, for the purposes of surety underwriting, supply contract bonds are those guaranteeing the faithful performance of contracts for furnishing supplies and material when such materials do not become part of the realty or attach thereto, at least until after the contract in question has been completed.

Supply contract bonds are required by the federal government, as well as by state, county, and municipal governments. The surety is liable for any loss sustained by the obligee through failure to secure the supplies in accordance with the conditions of the contract. This includes any additional expense attendant upon securing substitute supplies and may include loss or damage occasioned by delay.

Indicative of the types of supplies and material for which contracts covered by bonds are made are the following: ammunition, arms, automobile parts, fire hose, fuel, rolling stock, pipe, office furniture, filing cases, books, desks, seats, printed matter, electric current, railroad ties, and water softener. Contracts for furnishing engines, boilers, printing presses, electrical machinery, pumps, and other machinery are regarded as supply contracts if the machinery is built complete for sale at the factory or premises of the seller.

Maintenance Bonds. These bonds are given to guarantee that the principal will maintain in good condition all or some part of a construction project. The bonds are also used in connection with supply contracts when actual performance of the material sold is guaranteed by the seller.

The maintenance bond finds frequent use in connection with highway construction work for federal, state, borough, township, and municipal governments.

In connection with building contracts, the element of maintenance is most often found in a guarantee that the roof will last without leaks or the development of other defects for a stated period of years. Such guarantees are sometimes made in connection with the use of materials manufactured for special purposes, such as waterproofing, insulating material, or paints. Maintenance in connection

with supply is found when the contract guarantees performance of the material, as is frequently the case in contracts for the sale of oil for use as a dust palliative.

Miscellaneous Contract Bonds. A number of bonds are written for contractors that do not fall into the category of construction, maintenance, or supply. Among these may be included bonds guaranteeing the fulfillment of charter parties, bonds to the state for the lease and hire of state convicts, bonds given in connection with draying and hauling contracts, stevedoring contracts, contracts for the transportation of school children, bonds guaranteeing payment of general average adjustment, bonds required by state or public commissions guaranteeing the completion of an irrigation project, bonds guaranteeing payment of rent or the performance of other convenants in a lease except convenants to build, bonds guaranteeing against infringement of patents, bonds given by printers to the controllers of patented paper covering the use of such paper for specific purpose, bonds guaranteeing to replace property in its original condition, and bonds given by realty operators to a county guaranteeing to construct or finance improvements.

In this category are to be found deficiency judgment and demolition bonds. A deficiency judgment bond is given in favor of lenders furnishing money to finance the cost of a building improvement. The bond guarantees payment of the mortgage or any deficiency judgment on foreclosure. Demolition bonds guarantee to indemnify the holder of an existing mortgage or other lien on a property against impairment of security by the demolition of existing buildings for the purpose of making other improvements.

Other bonds in the miscellaneous group are those given in connection with United States mail contracts, for city delivery and collection service, pneumatic tube service, and carriage of the mail between post offices in rural districts under star route contracts.

Premium and Rates. Construction contracts for rating purposes are divided into class A and class B contracts. The rate for class A contracts is three-fourths of 1 per cent of the contract price for a period of twenty-four months or any fraction thereof. The renewal premium is determined by applying the same rate to the amount of the unfinished contract at each annual renewal. Class B contracts take a rate of 1½ per cent of the contract price for any period up to

twenty-four months, with an annual renewal rate of three-fourths of 1 per cent on the amount of the unfinished contract. Specific rates are promulgated in hazardous undertakings.

The list here given is by no means complete but will serve to indicate the types of operations assigned to each class. Included in class A are contracts for the preparation, leveling, or surfacing of sites for airports, golf courses, and playgrounds; for furnishing broken stone, sand, and gravel to highway departments; for furnishing and erecting fences and guard rails; glazing; machinery made to special order; high pressure power piping systems; lock gates; mosquito control; planting and cultivation of land; quarrying stone; refrigerating plants on land; resmelting old metal; waterproofing; and work and labor on personal property only. Class B includes building contracts of all kinds, erection as well as repair, and all work on or under land or water, such as the construction of aqueducts, breakwaters, canals, dams, jetties, sea walls, ditches, docks, excavations, foundations, masonry, sculptures, sewers, subways, terminals, tunnels, waterworks, and the like.

A most important feature of the premium computation of construction contracts is to be found in the fact that the contract price, and not the penalty of the bond, is the base to which the rate is applied. Thus, on a $100,000 contract the rate is applied to this sum, regardless of the penalty of the bond. The contract price is defined by the rating manual to be:

> The whole sum of money and/or other reimbursement which has passed from the owner to the contractor when final settlement between the two has been made; (excluding any bonus for "*time*") and if this sum is different from the original estimate, the premium must be adjusted accordingly; either by refund of part of the original premium by the surety if the original estimate was larger than the actual contract price; or by payment of additional premium by the contractor if the original estimate was smaller than the actual contract price.

This rule has the effect of bringing the cost of extras decided upon after the contract has been let within the contract price, and a bond premium must be paid thereon.

In cases where the bonds required are less than 15 or 20 per cent of the contract price, the face of the bond may be used as the basis for computing the premium, but the premium rate is sharply advanced. For example, on construction contracts subject to the rate of $15 per

$1,000 on the contract price for twenty-four months, bonds which are less than 20 per cent of the contract prices may be written at a rate of $75 per $1,000 per annum on the penalty of the bond. In the case of construction contracts, rated at $7.50 per $1,000 on the contract price for twenty-four months, bonds which are less than 15 per cent of the contract price may be likewise written at $50 per $1,000 per annum on the penalty of the bond.

Comparable rates are quoted when the contract is on a cost-plus-a-fixed-fee basis or on a cost-plus-percentage basis. A rate is quoted to be applied to the cost to the owner, or a higher rate to be applied to the penalty of the bond.

Premiums for proposal bonds are nominal. A flat premium of $5.00 is charged on construction contracts of $2,500 or more, and is less for smaller contracts, subject to a $1.00 minimum. This premium is held to be fully earned by the submission of the bid, whether successful or not. If the bid is successful, and the contract is awarded to the bidder, the amount charged for the bid bond is credited to the premium for the final bond.

Rates on maintenance bonds are quoted in terms of percentage, and the premium is determined by applying the rate to the penalty of the bond. If the bond limits its guarantee to "defective materials and /or workmanship" the manual rates apply, but if the maintenance guarantee includes "efficient or successful operation" for a period of one year or more, the manual rates are increased 100 per cent.

Special Provisions and Exclusions. Bond forms are by no means uniform. Not infrequently the obligee supplies his own form, incorporating his own terms and conditions. Surety companies supply printed forms that are widely used, and certain stipulations are to be found in most bonds of this kind.

The surety requires prompt notice of any failure on the part of the principal that may involve the surety. The surety usually reserves the right to itself to complete the contract upon default of the contractor and is to be subrogated to all of the rights of the contractor under the contract. The surety excludes liability for loss or damage resulting from strikes or other labor difficulties, mobs, riots, fire, the elements, or acts of God such as tornadoes, cyclones, earthquakes, and the like. No change is allowed in the plans, specifications, or terms of the contract if the change increases the price beyond a stipulated percentage of the contract price, unless consented to by the surety. The

owner is required to retain a percentage of the contract price until after the work has been completed and accepted.

A construction contract bond is automatically canceled with the completion and acceptance of the work free of all liens. There is no provision in the bond that permits the surety to cancel before the work covered by the bond is completed, and the surety has no power to terminate its liability once it is assumed pending completion of the work. The same rule applies to supply and maintenance bonds. Each is automatically terminated with the fulfillment of the conditions of the contract by the principal, and the surety has no means for terminating liability through cancellation.

Agent's Authority. Few agents have authority to bind or in any way commit a surety company on a contract bond. When the agent possesses a power of attorney from the home office of the company, properly executed by duly authorized officers of the company, his authority is strictly limited by the terms of this document. In no case does the local agent possess the broad powers to bind risks which are enjoyed by the agent of a fire company, though owners familiar with the customs and practices of fire agents have sometimes assumed that the same authority is given surety agents.

An agent without authority cannot bind his principal unless the principal conducts himself in such a manner as to lead third parties to believe that agency exists. Architects and contractors know of the limitations of the authority of local agents to execute contract bonds. For this reason it is considered an excellent practice to insist that to every contract bond there be attached a duly authenticated copy of the agent's power of attorney to execute the bond. This is neither an unusual nor an unreasonable request, and most bonding companies anticipate it by having forms specially prepared for the purpose.

FOR REVIEW

1. Is there a standard form of construction contract bond?
2. B contracts to build a garage for Y. B supplies a contract bond. During the course of operations an explosion kills five men and so damages the job that B is forced to abandon it. Y's attorney claims that the bonding company must complete the job but is uncertain as to his client's status with reference to the employees who were killed. What advice can you give?
3. B has been engaged for many years in the construction of buildings. Dur-

ing a dull period he files a bid to construct a tunnel. In the event that he is awarded the contract, what unfavorable factor may present itself that will cause the surety company to hesitate to supply a contract bond?

4. The X Surety Company supplies a bid bond conditioned that if the contract be awarded to B he will sign the contract and furnish contract bond within the required time. If B is awarded the contract, may the surety decline to supply the performance bond?
5. The Blank Surety Company supplies B, a contractor engaged in street paving, with a maintenance bond conditioned that B will maintain a certain street in good condition for a period of five years after its completion. Due to an unforeseen defect in the subsoil, a section of the road caves in. There is nothing wrong with the workmanship or the materials put into the job. Is the contractor obligated to replace the paving, and if he fails to do so, is the surety liable?
6. B, a general contractor engaged in street paving, incorporates his business as the Blank Construction Company. His company secures a contract to build twenty miles of road and is required to supply a maintenance bond covering a period of ten years. If after two years B should die and the corporation be dissolved, what would be the position of the surety company if a serious defect should develop two years after the dissolution of the corporation?
7. The Black Diamond Coal Company contracts to supply 100,000 tons of coal to the government over a period of two years at $8.00 a ton. The government requires a supply contract bond. The contractor anticipates a free market, but because of a strike the coal advances to $15.00 a ton. As a result of this advance the contractor is forced into bankruptcy. What is the position of the parties?
8. B contracts to purchase from A, 100,000 cords of pulp wood at $10.00 a cord. Pulp wood drops to $8.00 a cord, and B refuses to buy. The purchase price agreed upon being $1,000,000, what would be the liability of the surety company if it guaranteed this contract of purchase?
9. When is the liabilty on a construction contract bond terminated?
10. There are seven bidders on a construction job. The average of six bids is $95,000, with a range between $90,000 and $100,000. The seventh bidder has submitted a figure of $80,000. He has been awarded the contract and is applying for a bond. What will be the reactions of the underwriter?
11. The representative of the Consolidated Insurance Agency has advised the officers of a bank, supplying money to build an apartment building, that they should insist upon both a contract bond and a completion bond. The borrower states that since the contractor is supplying a contract bond, this is all that is necessary, since the contract bond obliges the contractor to complete the work in accordance with the terms and specifications. What is your opinion as to the need of a completion bond?
12. X is a contractor making an application for a contract bond. His statement shows cash on deposit, in two banks, amounting to $30,000. In addition to

verifying these balances, what other information regarding bank accounts will the bonding company require?

13. A lending institution insists upon a completion bond, and the borrower is willing to post it. The borrower wishes, however, to save the premium of a contract bond and indicates that he is satisfied to let the construction work without such a bond. May a completion bond be issued on a construction job where no contract bond is required?

CHAPTER XLIII

OTHER SURETY BONDS

CLASSIFICATION. In addition to the bonds already noted, the surety rating manual lists three classifications as follows: (1) depository and miscellaneous, (2) license and permit, and (3) federal. Bonds in these classifications meet a wide variety of needs, and numerous forms are available to comply with statutory requirements or the needs of private enterprise. Only the more widely used of these coverages are here considered.

Depository Bonds. Depository bonds guarantee that a bank in which funds are deposited will pay the funds so deposited on demand. The bond is a guarantee of the continued solvency of the bank during the period the bank serves as a depository for the insured's funds.

Depository bonds were once an important classification. These bonds were to a large degree required for the protection of public money. With recent changes in banking legislation and the advent of federal deposit insurance, the need for depository bonds has to a large degree passed and such bonds are rarely required today.

Owners of private funds do not usually require this type of surety, though bonds may sometimes still be required in connection with deposits of funds of fraternal orders, life insurance companies, savings banks, churches, and other like institutions under private ownership and control.

Lost Securities Bonds. In order to secure a duplicate of a lost instrument, the party requested to issue the duplicate may require a surety bond guaranteeing indemnity in the event that loss is sustained through presentation of the original instrument. This type of bond is required to secure a duplicate of a life insurance policy, certificates of membership in fraternal and beneficial orders or mutual associations having the effect of life or accident insurance policies, or certificates of membership in boards of trade, stock exchanges, and other like organizations when the instrument is lost, stolen, or destroyed.

The bond takes its name from the fact that it is frequently used in connection with lost securities, including bonds, stocks, government checks, warrants, and certificates of indebtedness. It is also used in the case of lost bills of lading, warehouse receipts, certified checks,

cashier's checks, bank drafts after acceptance, certificates of deposit, and savings bank books.

The premium for this type of bond is paid when the bond is issued, and no further payments are required. The single premium is the consideration for the entire term of the bond.

Mausoleum Bonds. Bonds given in connection with the contract for the construction of a mausoleum are classed as construction contract bonds and are subject to the rules thereof. The building of a private mausoleum is rated as a class A contract, while public mausoleums are rated in class B.

Mausoleum companies frequently enter into an agreement with a cemetery to erect a mausoleum and guarantee through the sale of crypts to raise sufficient money, not only to pay the construction cost of the building, but to provide a fund for its endowment. Bonds given in connection with this type of contract are classed as financial guarantees. The bonding company under its contract guarantees, not only that the required sum of money will be forthcoming, but that it will be honestly devoted to the fulfillment of the contract.

Students' Bonds. Educational institutions may require students upon registration to file a bond guaranteeing to indemnify or reimburse the institution for loss through failure of the student to pay tuition charges, fees, room rent, board, and other bills. The bond also covers loss caused by damages to rooms, grounds, or other properties of the institution for which the student is responsible.

The surety on a student's bond is frequently a parent. Bonds are required only in small amounts, and a parent ordinarily is willing to assume responsibility for the educational obligations of children. If the institution requires corporate security, or if for any other reason it is to be desired, the bond may be secured from a surety company.

Intoxicating Liquors, Beer, and Wine Bonds. With the enactment of repeal legislation and the further enactment of specific legislation governing the sale of liquors, beer, and wine, the states, counties, cities, and other political subdivisions having jurisdiction have required the filing of a surety bond in connection with the granting of licenses or permits for transportation or sale of these beverages.

The nature of the bond and bond requirements varies in different jurisdictions. In the class of permittees of whom the statute may require a bond are to be found brewers, distillers, warehousesmen, importers, wholesalers, distributors, retailers on the premises, retailers

on or off the premises, clubs, hotels, restaurants, boats, railroad dining cars, drug stores, grocery stores, confectioners, and the like.

Transportation bonds are written for railroads, steamship lines, ferryboat companies, and trucking concerns when required in connection with the transportation of liquors, beer, or wine.

Bonds Required by "Blue-Sky Laws." The various states have enacted laws governing the selling of securities. The bonds required to license or qualify investment companies, firms, or corporations engaged in the selling of securities, or their agents or representatives, differ in the various jurisdictions. Some states have statutes covering the filing and licensing of dealers, and varying degrees of statutory liability are to be found. Corporate surety bonds are available to enable individuals or business establishments to comply with statutory requirements covering the sale of securities for issuers, dealers, agents, incorporated banks and trust companies, brokers, and corporations selling their own securities.

Leased or Borrowed Property Bonds. The militia, reserves, Red Cross, American Legion, and similar organizations must satisfactorily account for or return all arms, tentage, equipment, and other material issued or loaned by the government. The same is true of small arms and other military equipment supplied by the War Department to educational institutions for military instruction. Surety bonds covering the agreement are required of the borrower by the War and Navy Departments at the time the loans are made.

In the case of property loaned for exhibition or other use by governments, libraries, museums, historical associations, and other like organizations, the lending institution may and frequently does require a bond guaranteeing the safe return of the loaned property. Sometimes the borrower of the property agrees, in addition to returning it safely, to make a money payment to the owner in the nature of a rental, royalty, share of receipts from exhibiting, or other payment. When required, the bond may be conditioned to guarantee both the return and the money payment.

Collateral Trust Receipts. Banks holding collateral as security for a loan frequently turn over substantial amounts of the securities deposited to the control of the customer to facilitate necessary business transactions. Securities so turned over must be replaced by acceptable substitutes. Banks allowing collateral to pass in this manner into the control of customers frequently require a bond indemnify-

ing them against loss through the failure of customers to return securities as agreed.

Security companies write bonds of this type under two forms. A separate bond may be written covering one borrower thus entrusted with collateral, or a blanket bond may be written covering a schedule of all borrowers.

Transfer Agents' Bonds. Corporate indemnity is written covering transfer agents against loss arising from their business dealings. The usual bond protects the transfer agent against loss arising from the cancellation of any stock certificates and issue of another in its place under a different name. Coverage extends to loss caused by the transfer of stock to the name of some person other than that filled in on the assignment.

Bonds of this class are written on two classes of risk. Under the first class, the coverage applies to concerns acting as transfer agents for issues other than their own. This type of institution makes a business of acting for a large number of corporations. The second group of risks is made up of those corporations which act as transfer agents for their own stock issues only.

In connection with the writing of these bonds, provision is made to extend the coverage, for the payment of an additional premium, to include loss caused by errors made by employees in the issuing of stock certificates. The rider covers loss occasioned by the issuing of the wrong kind of stock or stock of the wrong issue.

Purchase or Sale Bonds. In connection with contracts of purchase or sale that are not to be classed as supply contracts, it frequently happens that because of the nature of the transaction a bond guaranteeing the contract is required. A bond of this type is usually required by a state, county, municipality, or other political subdivision from bankers or bond dealers to guarantee a contract for the purchase and payment of public or municipal bond or note issues at a stated price. Similar bonds guaranteeing contracts for the purchase and payment of other state, municipal, or public property may be required.

Such a bond is sometimes required by a seller in a contract of purchase and sale between private persons. The bond is given when, under the terms of a contract, a buyer guarantees to take a stated quantity or all of the product of a seller at an agreed price, which may

be a stated sum or "at the market." Under a contract of this type, the seller, by guaranteeing a stated proportion or all of his product to the buyer, is not free to sell the goods contracted for to others. Failure of the purchaser to carry out his part of the agreement means loss to the seller.

The risk is not to be confused with that covered by a supply contract bond. The supply bond covers loss to the purchaser if the goods contracted for are not forthcoming as agreed.

Assigned-Accounts Bonds. When a merchant assigns his accounts to a banker or other lending agency as security for a loan the lending agency may require a bond to fortify the assignment. Such a bond may be written guaranteeing: (1) that none but valid accounts are assigned, (2) that collections of assigned accounts will be turned over by the merchant to the lender, and (3) that none but valid accounts are assigned and that the proceeds thereof as collected will be turned over to the lender.

If accounts assigned as security for a loan are deposited with a separate interest, such as a bank or trustee having no common interest with the borrower, such bank or trustee may likewise be bonded for the benefit of the lending agency.

Brokers' and Auctioneers' Bonds. When property is entrusted to brokers or commission merchants for sale, the owner frequently requires a bond guaranteeing the return of the property if unsold, or accounting for the proceeds if sold. When the rolling stock or other property or equipment of a railroad is delivered to a broker for sale, a bond of this type may be required, and the same is true in the case of boats, yachts, steamships, and other vessels.

Bonds are written providing for the varying needs of auctioneers. Private individuals, firms, or corporations making use of the services of an auctioneer may require a bond guaranteeing a faithful accounting of proceeds, or the bond may guarantee in addition that the net proceeds of any sale will not be less than a stipulated amount. The United States Post Office Department requires a bond covering the annual sale of unclaimed mail, as do the United States District Courts in the case of sales of bankrupt estates.

State and Municipal License and Permit Bonds. The usual purpose of the license and permit bonds required by state, county, city, town, village, or other municipality is to indemnify the municipality

or other public authority against the violation of the terms of the license or permit. Bonds may be required to extend the indemnity to third parties who may be injured.

Indicative of the class of license or permit for which bonds are required, the following examples may be cited: abattoirs, blasting operations, building operations, boarding houses, cigarette dealers, collection agencies, abstractors, assayers, contractors, detectives, electrical contractors, electricians, employment agencies, dealers in explosives, fumigators, funeral directors, game dealers, garage and filling station operators, hack or taxi drivers, hunters, house movers, junk dealers, loan companies, nurserymen, pawnbrokers, peddlers, pilots, plumbers, public accountants, public movers, secondhand dealers, ticket brokers, and travel bureau operators.

The foregoing list is by no means complete, nor are the requirements of the different jurisdictions identical. In the instances here cited, when a bond is required the usual condition is indemnity to the public authority against violation of the terms of the license or permit.

Insurance Company Statutory Bonds. In a number of the states, a satisfactory surety bond is acceptable in lieu of certain other requirements to enable an insurance company organized outside that state to qualify as an admitted company. The bond is written for a sum prescribed by the statutes and guarantees the payment of any liability incurred under policies issued in the state.

Bonds may also be required by the state for the faithful performance of duties by officers or agents of insurance companies, mutual-aid assessment companies or associations, and fraternal orders.

Exhibition Permit Bonds. In granting a permit to hold exhibitions within the limits of a municipality or other political subdivision, the granting authority frequently requires that a bond be filed guaranteeing the payment of any damages sustained by third parties. Bonds of this type are written by surety companies but ordinarily only with collateral, or with a liability policy covering the third party risk, written in the name of the principal but payable to the surety as its interest may appear.

Public Warehouse and Grain Elevator Bonds. The state laws in most jurisdictions require that the owners of public warehouses and grain elevators give a bond for the benefit of the holders of the warehouse receipts, and such bonds are required by certain agencies of the

federal government, such, for example, as the Commodity Credit Corporation.

The warehouse bond guarantees that the merchandise described in the storage tickets, warehouse or compress receipts, unloading certificates, bills of lading, or any other receipt or certificate for grain, cotton, tobacco, rice, or other agricultural product shall be delivered upon presentation of the receipt and in accordance with its terms. The holder of a certificate, or lender upon the credit of a certificate, is protected against the issuance of fraudulent documents as well as against the fraudulent removal of the commodity for which the paper was issued.

Federal Internal Revenue Bonds. The federal government requires the filing of a bond as a condition precedent to the granting of a permit to manufacture and distribute certain articles subject to an internal revenue tax. The bonds guarantee that the principal shall comply with the regulations of the government and pay all taxes in the amount and in the manner required.

In connection with the manufacture and distribution of intoxicating liquors, bonds are required of brewers, distillers, rectifiers, winemakers, and those operating warehouses or engaged in transportation.

Bonds are required in connection with the granting of a permit to operate an industrial alcohol plant, to establish a bonded warehouse, or to operate a plant for denatured alcohol. A bond is likewise required of dealers in denatured alcohol and of manufacturers using the product.

Manufacturers of cigars, cigarettes, and snuff are required to file bonds guaranteeing that the principal will comply with all legal requirements, that he will not attempt to defraud the government of the tax, and that, where required, he will affix the revenue stamp in accordance with government regulations. Bonds are written for the four following classes: (1) tobacco manufacturers, (2) cigar and cigarette manufacturers, (3) leaf tobacco dealers, and (4) tobacco peddlers.

Manufacturers of oleomargarine, adulterated butter, renovated butter, and filled cheese are required to file bonds similar to those required of tobacco manufacturers.

Export Bonds. The internal revenue tax is not required if the article, otherwise subject to the tax, is exported. Tobacco, snuff, cigars, playing cards, mixed flour, oleomargarine, adulterated butter,

and like products, destined for export, may thus be shipped free of tax. With the granting of a permit to accomplish this, the government requires a bond guaranteeing the amount of the tax and providing for penalty in the event that the goods, for which the permit is granted, are not actually exported or if, after export, they are fraudulently returned to the country.

Immigrants' Bonds. Under the federal immigration laws, aliens not otherwise admissible to the country may be admitted temporarily for the purpose of securing medical or hospital treatment and as students, tourists, or visitors. Aliens so admitted are required to file a bond guaranteeing departure from the country within a certain agreed period.

In the case of immigrants admitted, bonds may be required guaranteeing that the alien shall not become a public charge. Hospitals, sanatoriums, and other institutions treating alien patients may file a single bond covering a definite or indefinite number of alien patients.

In connection with the Chinese exclusion laws, bonds are written covering Chinese seamen on shore leave, the entry of exempt Chinese, Chinese students, and Chinese in transit. The last-named bond is required of transportation companies.

Custom House Bonds. In connection with custom laws and regulations, numerous permits are granted. When the granting of the permit carries with it an obligation on the part of the permittee, a bond is required conditioned upon the fulfillment of that obligation.

In the case of certain items ordinarily dutiable, a permit may be secured for their temporary importation. The property of troupes; shows; operatic, theatrical, and amusement companies; works of art; models; model gowns; and samples may be temporarily imported for a period of six months. The same is true of animals for exhibition or breeding purposes and automobiles of tourists. The bond required guarantees the export of the items in question within the limitation set and is obligated for the amount of the duty plus penalties in the event of failure of the importer to comply.

Importers may secure a permit to store imported merchandise in a bonded warehouse for a period not to exceed three years. Upon merchandise so imported and stored under permit, no duty is required until the merchandise is withdrawn. If the merchandise is re-exported, no duty is collected. When a permit of this kind is

granted, the government requires a bond guaranteeing that the goods will be withdrawn within three years and the duty paid or that they will be re-exported within the period.

FOR REVIEW

1. Some states have enacted laws requiring dealers in gasoline and motor oil to furnish a surety bond to the state guaranteeing compliance with the law with respect to taxes. From the standpoint of the surety company, indicate the underwriting problems involved.
2. A certain state has $5,000,000 on deposit in five different banks. The state requires a depository bond from each financial institution in the amount of $1,000,000. In the event that one of the banks should close at the end of six months and suspend all payments, what would be the rights and obligations of the surety company?
3. X is a security salesman. He makes certain statements that upon investigation are proved to be deliberately false. An inexperienced investor, relying upon these statements, suffers a loss of $10,000. What possible recourse has she through the agency of a bond?
4. You are the cashier of a bank and have loaned $10,000, accepting warehouse receipts for grain as collateral. The loan is defaulted, the receipts are sold, and upon presentation at the warehouse it is found that delivery of the grain cannot be made because it has already been moved upon presentation of a forged receipt. As cashier of the bank, what steps do you take to meet such contingency?
5. B receives from the X Corporation rights to subscribe for a new issue of stock. Not being in a position to subscribe and not knowing that the rights are salable, B throws the certificate showing his right to subscribe to the new issue in a waste basket. Later, learning of the value of the certificate, he makes a search and is unable to locate it. A lost-securities bond is filed, and a duplicate certificate issued. Later the original certificate is presented to the issuing company. Who suffers the loss, B or the surety company?
6. The Blank Mutual Company is asked by a state in which it wishes to qualify to do business to deposit securities in the amount of $200,000 or file a satisfactory bond for a like sum conditioned upon the payment of any claim for which the company may become liable under policies issued in the state. The Blank Casualty Surety Company, a stock company authorized to do business in the same state, is offered the bond. If you regarded the risk as safe, justify the refusal of the risk, as a matter of policy.
7. B is the owner of a fairground and, as part of the attractions, displays fireworks every night. The city, before granting a permit, requires all exhibitors to supply a bond guaranteeing the payment of all claims for damages growing out of injuries to spectators. How does this bond differ from a liability insurance policy?
8. The laws of a number of states require dealers in milk to file a bond

conditioned upon the payment of milk bills at stipulated intervals. Some dealers have difficulty in securing such bonds and contend that the law is unjust. What is your opinion?

9. Z, a citizen of China, is suffering from an ailment diagnosed as a brain tumor. He learns of an eminent surgeon in Boston to whom he wishes to go for an operation and yet, because of the Chinese exclusion laws, fears that this cannot be accomplished. You are asked for an opinion. Advise.
10. B is engaged in the business of importing and exporting. He has orders from time to time for merchandise manufactured in England to be delivered to various parts of South America. There is an import duty on the products if imported into the United States. How can B avoid paying the duty without violating the revenue law?
11. Distinguish between the underwriting problems of the tobacco manufacturers' bond and the cigar manufacturers' bond.

CHAPTER XLIV

CREDIT AND TITLE INSURANCE

CREDIT INSURANCE

SURETYSHIP or Insurance. Credit insurance is a contract under which an insurer, in consideration of a stipulated premium, undertakes to indemnify the insured against loss occasioned by the insolvency of creditors.

The contract follows the form of an insurance policy; but because of its nature, the question was raised in the early days as to whether it was in fact a contract of insurance or of surety. While recognizing the similarities between suretyship and credit insurance, the courts have held that credit insurance agreements are in fact contracts of insurance and should be treated as such.

The outstanding distinguishing feature between a strict guaranty and insurance in the credit contract is to be found in the fact that the credit risk is not based upon the individual standing of the primary debtor but rather upon the credit experience of a large group of debtors belonging to a certain class. A second distinguishing feature is to be found in the fact that in the case of a guarantor the agreement is made for the accommodation of the debtor, usually as a basis for securing credit. In credit insurance, the policy is secured by the creditor without any co-operation on the part of the debtor and may be obtained without his knowledge or consent.

Development of Credit Insurance. Insurance historians date the origin of the idea of credit insurance from an undertaking proposed in 1837 for the organization of a $10,000,000 corporation "to guarantee notes and contracts and collect debts." The idea was not readily adopted, and even during recent years the use of credit insurance has been limited.

The United States Credit System of New Jersey was incorporated in 1889 and was the first organization of the kind to operate over a period of years. This company was unable to weather the depression of 1893 and went into receivership in 1898. The American Indemnity Company appeared in the field in 1891, and other pioneer writers of the line include the Ocean Accident and Guarantee Corporation, Ltd., entering the field in 1895, and the London Guarantee and

Accident Company, Ltd., entering in 1905. Other companies have since followed, and statutes have been enacted in a number of jurisdictions specifically providing for the organization of credit insurance companies or making provision for the writing of the line by foreign companies.

Notwithstanding developments to date, credit insurance is still in an experimental stage. It is by no means a major branch of the insurance business, though the demand for the coverage is increasing and appearing in fields where coverage has hitherto been unavailable.

Underwriting the Risk. It is not the function of credit insurance to replace credit investigations with a contract of indemnity. Rather, the insurance undertakes to furnish indemnity for unforeseen losses where credit investigations are made and a reasonable scrutiny of accounts to reduce losses to a minimum is the practice.

Insurance companies place upon the liability they will assume a limitation based upon the credit rating of the customers of their insureds. Credit ratings are usually determined by references to the services of established mercantile agencies, such as Dun & Bradstreet, Inc.

Credit ratings are classed by insurance companies for underwriting purposes as preferred or inferior. Policies ordinarily are issued to insure the accounts of only those debtors with preferred ratings. If inferior ratings are covered at all, the coverage applying to the inferior classifications is very limited, and the policy is known as a "combination policy."

The Peril Covered. Credit insurance covers the peril of loss by the insured arising out of the insolvency of customers to whom credit has been extended. The question of the insurability of the risk has been settled by the courts, and it is now held that the peril of loss by the insolvency of customers is as real and definite as is the peril of loss by fire, lightning, or tornado.

The need for the coverage becomes evident when it is realized that credit losses reach a huge figure every year. Estimates place the total at $1,000,000,000 for a single year. The credit insurance contract issued in this country by domestic insurance companies has been available as a rule only to manufacturers and wholesalers. The terms and conditions of the policies issued vary widely. The more usual coverage provides that an insured will himself assume such credit losses as are normal to his particular business. The policy

undertakes to indemnify for any excess loss resulting from the insolvency of debtors to whom merchandise has been sold in the regular course of business.

There is a tendency to associate credit losses and insolvency with business incompetence. This line of thought assumes that the careful credit analysis of a credit executive will preclude the necessity for credit insurance. While it is true that many credit losses follow business incompetence, it is equally true that a large proportion of credit losses are the outgrowth of physical disaster. There are few individuals who have physical risks scattered throughout the country who would not provide a floater policy to cover them. Automobile dealers and those selling other items such as refrigerators, radios, pianos, and the like invariably provide insurance protection to cover them against losses growing out of perils such as fire, tornado, earthquake, and flood. The same insureds frequently do not see that perils such as fire, tornado, earthquake, and flood can make accounts receivable as valueless as physical property actually destroyed. It is a matter of fact that the accounts of a businessman doing business over a widespread area may be threatened by perils which are of little or no concern in his own area. Experience has shown that every catastrophe carries with it a trail of credit losses that extend their consequences to the far corners of the country. Only the credit men of active firms trading in areas where there have been disasters caused by cyclones, floods, fires, or other catastrophes have any real knowledge of just how far-reaching are their effects in the credit field. This is true because many of the victims of disaster are frequently wiped out so completely that no effort whatever is made to collect their accounts, and there are few records of bankruptcy of this sort. While, as a matter of theory, accounts receivable are beyond reach of physical damage because they represent claims, their asset value is actually subject to every physical hazard that threatens the assets of the creditor.

Types of Contract. Credit insurance policies may be issued to cover in a group the accounts of an insured, and when so written the policy is termed "general." In contrast to this type, contracts are sometimes issued upon certain definitely indicated accounts, and the policy is classed as "specific."

Specific policies are further subdivided into single-account forms and approved-account forms. The single-account policy is used when an unusual line of credit is extended to an individual customer. A

policy of this sort can be issued only after investigation by the company of the standing of the debtor and any other circumstances affecting the risk. The approved-accounts policy indemnifies the insured, in accordance with the policy conditions, for losses incurred on a specially designated list of accounts upon which the company has assumed liability.

Policy Term. Credit insurance policies are usually written for a term of one year. Two forms are written with reference to the covering of losses that occur after the end of the policy term. Term policies cover losses through insolvencies on sales made during the term, while continuing policies cover losses through insolvencies occurring during the term. It is assumed that continuing policies will be renewed from year to year. Under a term policy, a loss for which the insurer is liable may occur after the end of the specified period for which the policy was written.

Credit insurance policies are terminated if the insured becomes insolvent during the policy term or if issued to a partnership and the partnership is dissolved.

Insolvency. Since the insolvency of debtors is the peril covered by a credit policy, it is essential to have a clear understanding of the meaning of the term as used in the contract. It is held that in the absence of words limiting the meaning of "insolvency" to a definition set forth in the policy, a debtor need not necessarily be adjudicated a bankrupt to be insolvent. Failure to meet obligations in the usual course of business is sufficient to hold the insurer liable for loss.

In order to eliminate the necessity of depending upon a liberal construction of the policy, most contracts now set forth at some length the conditions which will warrant a claim on the ground of insolvency. All contracts do not agree on what constitutes insolvency. The following form indicates the breadth of the term as it applies to loss adjustments under a widely used form; the insolvency of the debtor shall be deemed to have occurred when:

1. The debtor shall have absconded;
2. The debtor shall have died;
3. The debtor shall have been adjudged insane;
4. A receiver shall have been appointed for the debtor;
5. The debtor shall have transferred or sold his stock in trade in bulk;
6. A writ of attachment or execution shall have been levied on the debtor's stock in trade and said stock sold thereunder, or the writ returned unsatisfied;

7. The debtor shall have made a general offer of compromise to his creditors for less than his indebtedness;

8. There shall have been a recording of or taking possession under a chattel mortgage given by the debtor on his stock in trade;

9. The debtor's business shall have been assigned to or taken over by a committee, appointed by a majority in number and amount of his creditors;

10. There shall have been a recording of or taking possession under an assignment or a deed of trust made by the debtor for the benefit of his creditors;

11. A voluntary or involuntary proceeding shall have been instituted to adjudge the debtor bankrupt;

12. A proceeding for the relief of the debtor shall have been instituted in a court of bankruptcy.

It is clear that the coverage is not restricted to the legal definition of insolvency. In addition to actual insolvency, the definition extends to provide protection in situations where collection might prove difficult because of impairment of assets. The definition of insolvency in different policies may vary somewhat in wording, but each follows the same general principle.[1]

[1] A definition that has proved acceptable both to insurer and insured and widely used in credit policies provides:

The insolvency of a debtor for the purpose of this policy shall be deemed to have occurred:

1. If and when a petition in bankruptcy or insolvency is filed by or against a debtor under the laws of the United States, or any State or Territory thereof, or of the Dominion of Canada;

2. If and when a debtor makes an offer of a general compromise to his creditors for less than his indebtedness;

3. If and when a receiver is appointed for a debtor;

4. If and when a sole debtor dies or becomes insane;

5. If and when there is a recording of or taking possession under a chattel mortgage given by a debtor on his stock in trade;

6. If and when an attachment or execution is levied on a debtor's stock in trade;

7. If and when a writ of execution against a debtor is returned unsatisfied;

8. If and when a debtor transfers or sells his stock in trade in bulk;

9. If and when a debtor absconds;

10. If and when a debtor makes an assignment, or a deed of trust, for the benefit of his creditors:

11. If and when the stock in trade of a debtor is sold under a writ of attachment or execution;

12. If and when a confession of judgment is made by a debtor;

13. If and when a debtor's business is assigned to or taken over by a Committee appointed by a majority in number and amount of his creditors;

14. If and when the Indemnified files with the Company for collection a claim against a debtor whose account is due and payable at the date of filing, but not over seventy (70) days past due under the original terms of sale:

15. If the Indemnified files with the Company for collection a claim against a debtor whose account is more than seventy (70) days past due under the original terms of sale, and when the Company reports to the Indemnified in writing that the debtor has no property subject to execution and that the account is uncollectible, such debtor will for the purposes of this policy be deemed insolvent at the date of such report.

Normal Loss. In every business, year in and year out, bad accounts are the occasion of some loss. This loss is to be expected and is absorbed as a charge-off each year. The amount of such losses can be calculated for any business within reasonably close limits and is usually expressed in a percentage of gross sales. This loss is recurring and for the purpose of credit insurance is termed the "normal loss."

It is not the function of insurance to provide indemnity for the happening of certainties. Consequently, the element of normal loss is not insurable. Every credit policy indicates a normal loss for the business insured, determined by previous experience and expressed in terms of a percentage of gross sales. There is no liability during a policy term by the insuring company until the insured has absorbed the amount set up as the normal loss.

Coinsurance. Since control of the extension of credit rests in the insured, underwriters have felt that credit extensions will be more carefully scrutinized by the insured if he is forced under the terms of the policy to bear a part of the loss. Accordingly, policies are written with the stipulation that the insured bear an agreed percentage of each loss.

The coinsurance features of the contracts vary. Percentages of 10, 25, and 33⅓ are usual. The higher percentages are used when the risk is greater, or in the case of an inferior rating coverage with high limits.

The term "coinsurance" as used in connection with credit insurance is sometimes confused with its application in the fire business. There is no clause in the credit policy that provides full recovery in the event that insurance to value is carried. In each case the insured is required to carry the indicated percentage of the loss. The condition is comparable to deductible coverage in marine insurance.

Governing Rating and Coverage. In the application for credit insurance a statement is made of the mercantile agency whose ratings are to be used. Under the section of conditions and stipulations, the policy provides that the governing rating of the debtor is to be understood to be the mercantile agency named in the application, and the name of the agency is inserted in the policy. The latest published rating book of this agency is used to determine the debtor's governing rating for coverage on shipments, and no loss is covered by the policy unless the debtor shall have had, at the date of shipment, a governing rating for which coverage is specified in the "table of ratings and

coverage" inserted in the policy. The gross amount covered on the total indebtedness of a debtor is limited, first, by the amount owed by the debtor to the insured at the date of insolvency and, second, by the amounts set opposite the governing rating of the debtor in the aforemenioned table. Table 5 is indicative of the normal maximum limits used in connection with the ratings of one of the leading mercantile agencies. The symbols in the first column indicate the

TABLE 5

RATINGS AND COVERAGE

HIGH		GROSS AMOUNT COVERED	GOOD		GROSS AMOUNT COVERED
AA	A1	$200,000	AA	1	$50,000
A+	A1	150,000	A+	1	40,000
A	A1	100,000	A	1	30,000
B+	1	75,000	B+	1½	30,000
B	1	50,000	B	1½	25,000
C+	1	30,000	C+	1½	20,000
C	1½	25,000	C	2	15,000
D+	1½	20,000	D+	2	12,500
D	1½	15,000	D	2	10,000
E	2	10,000	E	2½	5,000
F	2½	5,000	F	3	3,000
G	3	2,500	G	3½	1,500
H	3	1,500	H	3½	750
J	3	1,000	J	3½	500
K	3	500			
FAIR		**GROSS AMOUNT COVERED**	**LIMITED**		**GROSS AMOUNT COVERED**
AA	1½	$ 10,000	AA	2	$ 5,000
A+	1½	10,000	A+	2	5,000
A	1½	10,000	A	2	5,000
B+	2	10,000	B+	2½	5,000
B	2	10,000	B	2½	5,000
C+	2	10,000	C+	2½	5,000
C	2½	10,000	C	3	5,000
D+	2½	7,500	D+	3	5,000
D	2½	5,250	D	3	3,500
E	3	3,000	E	3½	2,000
F	3½	1,500	F	4	1,000
G	4	500	K	4	500
H	4	500	L	4	500
J	4	500	L	—	500
K	3½	500	M	4	500
L	3½	500	M	—	500
M	3½	500	N.I.B.	—	250

*N.I.B.: A debtor not named in the books or reports of the governing mercantile agency but using the merchandise in connection with and/or incident to an established business.

estimated pecuniary strength of a concern, and those in the second column indicate the general credit standing. For example, an AA rating of Dun & Bradstreet, Inc., would indicate estimated pecuniary strength of over a million dollars. This, coupled with the symbol A1, would mean a high rating, with 1 a good rating, with 1½ a fair rating, and with 2 a limited rating. A separate section of the table is made up for each of the four credit ratings. The final column in the table indicates the average limits of insurable risk which the insurance company is willing to cover on the basis of the credit ratings indicated.

Method of Adjustment. The policy sets forth the period within which the insured must file a claim in order to be within the coverage. A usual period is twenty days after acquiring knowledge of the debtor's insolvency and before the expiration of the policy. If information of a debtor's insolvency is received by the insured too late to notify the company during the term of the policy, such notification of claim may be filed with the company within, but not later than, twenty days after its termination. In filing a claim, the whole account against the debtor is placed with the insurance company for attention and collection. The company provides a form for giving notice, and this notice constitutes authority for the company to place the account for collection with any attorney it may select. The company undertakes to effect an adjustment within a period not to exceed sixty days after receipt by the company of the final statement of claim setting forth the amount ascertained to be due under the policy. To ascertain the net loss in any adjustment, the gross loss covered is determined and from this amount the following deductions are made:

1. All amounts collected from the debtor or obtained from any other source;
2. The invoiced price of goods returned, reclaimed or replevined, when such goods are in the undisputed possession of the indemnified;
3. Any discount to which the debtor would be entitled at the time of adjustment;
4. Any amount mutually agreed upon as thereafter obtainable;
5. Any legally sustainable set-off that the debtor may have against the Indemnified.

The Collection Clause. Most credit insurance policies are now written with a provision requiring the insured to file past-due accounts with the company for collection. Policies usually require the policyholder, during the policy term, to file for collection any insured

account after it shall become due and payable but before it shall have become more than sixty days past due under the original terms of sale. When a past-due account is filed with the company it is treated, for the purposes of effecting the adjustment, as if the debtor were insolvent. The company undertakes to effect a collection, and provision is made in the policy to deduct charges on collections following a schedule set forth in the policy. After the deduction of collection charges and expenses, remittance is made to the insured.

Cancellation. Credit insurance policies may be canceled upon written request of the insured. When such a request is made to the company all liability under the policy terminates, and the company agrees, upon surrender of the policy, to refund all premiums paid in excess of the customary short-rate premium for the period the policy remained in force. A minimum premium is provided, and in the event that a claim has been filed under the policy, the insured has no right to cancel. The company may cancel the policy at any time by giving written notice to the insured. After notice has been given, the company's liability terminates immediately as to shipments made thereafter but the cancellation is not effective as to shipments made prior to the serving of notice.

TITLE INSURANCE

Nature of Real Property. The law divides property into two classes, real and personal. The term "real property" refers to land and rights issuing out of land. Title to real property may be acquired in a number of ways, the more common being transfer with the consent of the owner, by will, and by descent regulated by statute. To secure title to the rightful owner, the law sets up certain formalities governing transfers. These formalities are technical and must be complied with in detail; otherwise, the transfer may be defective.

A transaction involving the sale of real estate usually involves substantial sums of money. The purchaser is interested in knowing that the seller has good title to the property being conveyed and that it is free and clear of all liens or other encumbrances. To satisfy himself of the title of the conveyor, he must have a search made at the record office covering all grants, conveyances, wills, liens, encumbrances, taxes, or other matters that might have the effect of clouding the title. A record of all matters affecting the title is made, and the document is called an "abstract."

The abstract in turn is referred to a lawyer skilled in this type of work. After carefully examining the abstract, the lawyer will give an opinion as to the title. The lawyer who undertakes to pass upon an abstract submitted to him has no means of knowing that the document has been correctly made. Neither can he tell that all parties whose conveyances are recorded had full capacity to contract. An examiner may overlook in the record some defect that may be vital, though many defects in title are of a nature that are not apparent from the record. It follows that the most careful scrutiny of the records by a competent attorney will not in every case bring to light existing causes which may prove a title to be defective.

The Peril Insured. The peril covered by a title insurance contract is loss growing out of undiscovered defect in the title to a property insured. The policy guarantees the title search to a purchaser, mortgagee, or other interested party, covering the insured against loss arising out of undiscovered defects in existence at the time the policy was issued.

In contrast to other forms of insurance, title insurance looks backward for the source of a claim, rather than forward. The usual insurance contract covers loss growing out of the happening of some unfavorable contingency subsequent to the issuance of the policy. Title defects which may arise following the issuance of a title policy are not within the scope of the coverage. To support a claim, the defect must have been in existence and undiscovered when the policy was issued.

The Title Insurance Company. Title insurance companies are large corporations with resources ample to the risks assumed. Unlike other insurance carriers, they tend to confine the scope of their activities to a limited territory. This is made necessary from the very nature of the business.

Since the abstract of title is the basis of the contract, title companies have built up elaborate sets of records which are based upon the real estate records of the territory in which their operations are conducted. These records are maintained constantly up to date and are sometimes referred to as an "abstract plant." This plan eliminates the necessity of making a complete search of title every time a transfer is made, and as time passes the company will find, as the result of extension of its activities, more and more properties upon which policies have been issued. The writing of a new policy upon a prop-

erty formerly insured involves only a reference to the records covering changes since the issuance of the last previous policy.

In urban communities where values are high and the real estate turnover rapid, title companies render an important service. In communities where values are low and transfers infrequent, the volume of business is often hardly adequate to support a title insurance company. In such communities the purchaser or mortgagee of real estate must be content with an opinion as to title from an examiner without the guarantee of an insurance contract.

The Policy. Title insurance contracts are not at all uniform, and the policies issued in one community are markedly different in detail from those issued in another. The forms issued to owners and mortgagees providing indemnity for loss or damage by reason of defects in the title or the unmarketability of the title are usually alike in certain essentials.

The insuring clause provides indemnity to the insured, his heirs, and devisees subject to an indicated limit: (1) by reason of any defect of the title of the insured to the estate or interest described in an attached schedule; (2) by reason of the unmarketability of the title of the insured described in the schedule; or (3) because of liens or encumbrances at the date of the policy, except the defects, estates, objections, liens, or encumbrances specifically scheduled as excepted, or excepted by the conditions of the policy.

The schedule describing the subject matter of the insurance sets forth: (1) the estate or interest of the insured; (2) a description of the property, the title to which is insured; (3) the deed or other in-trument by which the title or interest is vested in the insured.

A second schedule sets forth discovered defects that are, therefore, not within the scope of the protection. In this schedule are listed all defects or objections to title, liens, charges, or encumbrances that may be discovered as a result of the title search.

A final section of the policy contains the conditions and limitations of the contract between the company and the insured. The policy covers such subjects as assignment, subrogation, conditions supporting a claim, and the conditions governing loss adjustments.

Assignment. Assignment of a title policy is not permitted in the usual course unless the policy is held by the owner of a mortgage or other encumbrance, in which case the contract may be transferred to an assignee of the insured. It may also be transferred to the purchaser

at a sale under foreclosure where the property sold is bought by, or for, the insured. The company may by special agreement permit assignment in other cases.

Insurance companies view with concern the assignment of policies issued to the owner of an equity because, if the owner sells his property after holding it for a considerable period and at the same time undertakes to assign a title policy, the holder of the policy may be misled into believing that the policy protects him from the date of the transfer. It is apparent, of course, that no insurance company will undertake to cover title defects that may develop after the policy is issued without first having an opportunity to examine the record and determine whether or not it is willing to assume the risk. To obtain adequate and full protection, the only safe method in the case of the transfer of equity is to secure a new policy or have the current policy brought up to date. However, some policies, as has previously been stated, may be assigned with the consent of the company endorsed thereon. Under such conditions, the company is enabled to point out to the new policyholder the nature of the assignment and the necessity for carrying forward the effective date of the insurance. The following clause is widely used:

> No transfer of this policy shall be made, except that a policy held by the owner of a mortgage or other incumbrance may be transferred to the purchaser at a foreclosure sale where the property sold is bought in by or for the insured, and except also in such other cases as this company may, by special written agreement, permit; but no transfer of this policy shall be valid unless the approval of this company is indorsed hereon by its proper officer. Such approval may in any case be refused at the option of this company, and all interests in this policy (saving for damages accrued) shall cease by its transfer without such approval, so indorsed. The liability of this company to any collateral holder of a policy shall in no case exceed the amount of the pecuniary interest of such collateral holder in the premises described in the policy.

Policies written for a mortgagee frequently provide that the coverage will follow to a new interest when the nature of the mortgagee interest has been changed by foreclosure or other transaction. Thus, a mortgagee insured under the title policy that changes its status to a holder of title under foreclosure, trustee sale, or other legal process for satisfaction of the indebtedness secured by the mortgage continues to be covered under the policy. The provision in the policy that a new interest in such circumstances will be covered is not in effect an

assignment, but rather the continuation of coverage for essentially the same interest even though its legal character has been changed.

Subrogation. Whenever a claim is settled by the company, the policy provides that the company shall be entitled to all rights and remedies which the insured would have had in respect to the claim. The insured is obligated to transfer these rights to the company and permit it to use the name of the insured in any necessary action in connection with recovery or defense. When payment does not cover in full the loss of the insured, the company's subrogation rights are limited to the proportion that the amount paid by the company bears to the entire loss.

Conditions Supporting a Claim. The policy undertakes to defend the insured against suit, promising to defend in all actions or proceedings founded on a claim of title or encumbrance prior to the policy date. The policy then sets forth, in some detail, conditions under which loss may arise, which are in fact a description of situations covered by the contract occasioned by actions of ejectment, dispossession, or eviction founded upon a claim of title, lien, or encumbrance.

Adjustments. When liability has been definitely fixed, the loss is payable within thirty days. The company is given the right to demand a valuation of the insured estate or interest. The policy provides that such a valuation be made by three arbitrators chosen thus: one by the company, one by the insured, and an umpire chosen by both. The valuation may be fixed by the agreement of any two.

No right of action accrues until thirty days after a notice of the action of the arbitrators shall have been served upon the company, and the insured shall have tendered a conveyance of the insured estate or interest to a purchaser to be named by the company at such valuation less encumbrances.

A right of appeal from any adverse determination is reserved to the company. Such an appeal is not allowed to operate as a delay in the payment of the loss if the insured provides the company satisfactory security for the repayment of the amount of such loss in the event that determination is ultimately in favor of the company.

A Contract of Indemnity. In order to recover under a title contract, the insured must show that a loss has actually been sustained. When the insured is without title, the measure of damages under a title insurance contract would be, in the absence of any unusual cir-

cumstance, the purchase price. When title actually passes but a lien is subsequently discovered, the measure of damage is the cost of discharging the lien. When the defect is in the form of an encroachment, the measure of damage is the difference between the value of the property unencumbered and the value with the encumbrance.

The Term. The title insurance policy is personal and does not follow the property. It is usually perpetual, though sometimes the coverage is limited to twenty-five years. When the property insured is transferred, the insurance terminates, and if the new owner desires coverage a new policy is issued. Premiums are paid in a single payment at the time the policies are written, and no further payments are required during the term. Policies have been written containing a provision for a reduction in premium when reissued within five years from the date of the original insurance. This is not the usual practice, however.

Use of a Group Policy. A group insurance form has been devised for the convenience of large users of title policies such as, for example, life insurance companies and mortgage companies.[2] Under the plan, a master policy is issued with certificates indicating each risk to be covered. The convenience of such a form is recognized. It has a particular appeal to the mortgagee because he knows precisely the type of coverage he is securing on every risk; and there is no obligation on the part of the legal staff to scrutinize and examine a number of different forms, or even a number of different policies written on the same form, in which changes or modifications might be included in the course of their preparation.

The group form involves no difference in the underwriting procedure. It is simply the use of the master policy form with certificates that has found such general acceptance in other fields of insurance. The group form simply establishes that a uniform set of policy conditions applies to all the risks covered under the policy, and the individual certificates serve as evidence of insurance in the case of each particular risk.

FOR REVIEW

1. Is there a standard title insurance policy?
2. It is stated that the judicial construction of insurance contracts has tended to shape policy forms. Is this true in the case of title insurance?

[2] Rhodes, J. E., 2d, "The Contract of Title Insurance" (paper read at the annual meeting of the American Title Association, Springfield, Ill., October 7, 1936), p. 13.

3. Does the doctrine of insurable interest apply in the case of title insurance?
4. May the owner of a property have an insurable interest that may be covered by a title insurance policy after he has disposed of the property?
5. Does a mortgage have an insurable interest in the mortgaged property after release of the lien and satisfaction of the obligation which the lien was executed to secure?
6. In the case of a title insurance policy covering a mortgagor's interest and the interest of the owner of the fee, how, if any, does the risk covered by the policy differ?
7. B purchases a piece of property and is told by his attorney that he need have no concern with title difficulties because a title insurance policy has been secured. May the insured be satisfied that the title insurance policy affords him full protection against all claims growing out of a defective title?
8. To what extent is the insurer liable under a title insurance policy?
9. Are group title insurance policies ever written?
10. B has received a title insurance policy from his attorney. He contends that his policy should insure the marketability of the title. Is his contention sound?
11. Explain the meaning of credit ratings used as a basis for determining coverage under a credit insurance policy.
12. How does credit insurance serve as a safeguard for working capital as well as to protect the insured against insolvency losses?
13. Credit insurance tends to speed up capital turnover. What is meant by capital turnover, and how does credit insurance tend to speed it up?
14. In the case of credit insurance, when is the specific coverage contract definitely indicated?
15. Fire, flood, tornado, plague, drought, crop failure, or other local catastrophes may unfavorably affect the ability of a debtor to meet his obligations. Will credit insurance prevent loss from these sources?

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