Chapter 1

Insurance: Basic Principles and Concepts

I. INTRODUCTION

1-1 Overview

Broadly defined, insurance is a form of risk management used to hedge against loss. Traditional insurance is really just the equitable transfer of the risk of a contingent loss from one entity to another in exchange for consideration. The terms of the "deal" are contained in a contract (the policy) where one party (the insurer or carrier), for compensation (the premium), assumes particular risks of the other party (the insured or policyholder) and promises to pay an ascertainable sum of money for a specified contingency (first-party insurance) or promises to defend and/or indemnify from claims of liability (third-party insurance). The contingency element that introduces risk and the transfer of that risk from one party to another is the very essence of insurance.

1-1:1 The Insurance Policy

An insurance policy is a contract enforced as written when its terms are clear in order that the expectations of the parties will be fulfilled.[1] An insurance policy is interpreted by the court in accordance with its "plain and ordinary meaning,"[2] but because insurance policies are contracts of adhesion (contracts drawn by the insurer without any right of the insured to negotiate different terms), they are construed liberally "to the end that

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1. *Flomerfelt v. Cardiello,* 202 N.J. 432, 441 (2010).
2. *Mem'l Props. v. Zurich Am. Ins. Co.,* 210 N.J. 512, 525 (2012).

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coverage is afforded to the full extent that any fair interpretation will allow."[3]

If the terms are clear, they are given their plain and ordinary meaning.[4] The court cannot rewrite the policy's terms to find coverage where the policy plainly provides none.[5] If the plain language of the policy is unambiguous, the court will not engage in a strained construction to support the imposition of liability or write a better policy for the insured than the one purchased.[6]

The appellate standard for review is limited to the deference of the trial judge's findings as substantially influenced by his or her opportunity to hear and see the witnesses and to have the "feel" of the case which a reviewing court cannot enjoy.[7] An appellate court will not disturb the factual findings of the trial or motion judge, and legal conclusions drawn from those findings, unless convinced that they are so manifestly supported by or inconsistent with the competent, relevant and reasonably credible evidence.[8] However, the interpretation of insurance contract terms represents a question of law for the appellate court to determine without deference to the trial or motion judge.[9]

The court may rely on the reasonable expectations of the parties to construe a contract of insurance (1) to reflect the reasonable expectations of the insured in the face of ambiguous language and phrasing, or (2) in exceptional circumstances when the literal meaning of the policy is plain.[10]

Exceptional circumstances are narrowly confined and apply to policy forms that have characteristics of an adhesion contract. The court may vindicate the insured's reasonable expectations over the policy's literal meaning if the text appears overly technical or contains hidden pitfalls, cannot be understood without employing subtle or legalistic distinctions, is obscured by fine print or requires strenuous study to comprehend.[11]

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3. *Longobardi v. Chubb Ins. Co. of N.J.*, 121 N.J. 530, 537 (1990).

4. *Pizzullo v. New Jersey Mfrs. Ins. Co.*, 196 N.J. 251, 270 (2008).

5. *Oxford Realty Grp. v. Travelers Excess & Surplus Lines Co.*, 229 N.J. 196, 207 (2017).

6. *Templo Fuente de Vida Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 224 N.J. 189, 200 (2016); *Zacarias v. Allstate Ins. Co*., 168 N.J. 590, 595 (2001).

7. *State v. Locurto*, 157 N.J. 463, 471 (1999).

8. *Seidman v. Clifton Sav. Bank, F.L.A.*, 205 N.J. 150, 169 (2011).

9. *Adron, Inc. v. Home Ins. Co.*, 292 N.J. Super. 463, 473 (App. Div. 1996); *30 River Court E. Urban Renewal Co. v. Capograsso*, 383 N.J. Super. 470, 476 (App. Div. 2006).

10. *Abboud v. Nat'l Union Fire Ins. Co.*, 450 N.J. Super. 400, 408 (App. Div. 2017) (decided under an "insured versus insured" exclusion in a D&O policy).

11. *Zacarias v. Allstate Ins. Co*., 168 N.J. 590, 601 (2001).

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The test for determining whether an ambiguity exists is whether the phrasing of the policy is so confusing that the average policy holder cannot make out the boundaries of coverage.[12] The separate placement of an insurance policy's declarations sheet, definitions section and exclusion section do not necessarily give rise to an ambiguity.[13]

The expectations of coverage must be real and "objectively reasonable."[14] In assessing the reasonable expectations of the insured, the court will consider communications regarding coverage between the insured or its broker and the insurer or its agent that relate to the insured's expectation,[15] whether the scope of coverage is so narrow that it would largely nullify the insurance and defeat the purpose for which it was obtained,[16] and if the policy's unrealistically narrow coverage causes broad injury to the public at large, which requires the court to preclude enforcement on public policy grounds.[17]

1-2 Risk and Risk Concepts

1-2:1 What is Risk?

The term "risk" generally refers to an event that has the potential to cause a disruption or loss, either physical or financial, the consequences of which result in the redirection of assets to address that loss. In the insurance world the words "risk," "hazard" and "exposure" are often used interchangeably. When used in this context, all three terms refer to the potential of an adverse event causing a loss.[18]

There are many types of risk. In the insurance context risks are often grouped into "personal" risk, "property" risk and "liability" risk. "Personal" risk refers to loss of life, onset of bad health, disability, unemployment and just old age sometimes leading to loss of income or assets. "Property" risk refers to direct and indirect losses relating to real or personal property.

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12. *Nunn v. Franklin Mut. Ins. Co.*, 274 N.J. Super. 543, 548 (App. Div. 1994).

13. *Oxford Realty Grp. Cedar v. Travelers Excess & Surplus Lines Co.*, 229 N.J 196, 207 (2017).

14. *Abboud v. Nat'l Union Fire Ins. Co.*, 450 N.J. Super. 400, 410 (App. Div. 2017).

15. *Abboud v. Nat'l Union Fire Ins. Co.*, 450 N.J. Super. 400, 410 (App. Div. 2017).

16. *Abboud v. Nat'l Union Fire Ins. Co.*, 450 N.J. Super. 400, 410 (App. Div. 2017).

17. *Abboud v. Nat'l Union Fire Ins. Co.*, 450 N.J. Super. 400, 410 (App. Div. 2017) (quoting *Sparks v. St. Paul Ins. Co.*, 100 N.J. 325, 340-41 (1985)).

18. Some commentators have noted that some in the insurance world refer to both perils insured against and insureds as "risks," adding to the confusion. They point out that it is technically imprecise to refer to "perils" and "hazards" interchangeably as "risks." and that a "peril" is a cause of loss and a "hazard" is a condition that may increase the chance of a loss arising from a peril. Emmett J. Vaughan & Therese M. Vaughan, Fundamentals of Risk and Insurance, 8th Ed. (1999).

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Direct losses mean to the property itself. Indirect refers to consequential loss as a result of the direct loss. "Liability" risk refers to damage to a third party caused by actions of the insured. All three categories assume that the risk that may occur is uncertain and unintentional thereby introducing "chance" or "probability," important concepts in insurance.[19]

A person's appetite for risk will determine how one addresses it in the real world. A risk adverse attitude is one where there is a low threshold for potential loss. Someone who is risk neutral is indifferent to loss. One who is risk preferring is willing to take the chance that an event will happen after making a decision in advance to accept the consequences should it occur.

The insurance market provides alternatives to that segment of the population that is biased towards risk aversion. A person can choose to address risk aversion in several ways. Risk can be totally avoided. For example, someone concerned about injuring themselves skydiving can choose not to skydive. Risk can be reduced. For example, one can improve diet and fitness to combat the potential for deteriorating health. One can also assume, share or transfer risk. "Risk transfer" is the concept that marries risk to the insurance industry.

1-2:2 Risk Transfer

"Risk transfer" forms the basis of almost all insurance and refers to the shifting of financial responsibility for a contingent loss from one party to another. Risk transfer is the underlying tenet behind most insurance transactions. Risk transfer means taking a specific risk, which is normally detailed and defined and passing it from one party who does not wish to have this risk (the insured) to a party who is willing to take on the risk (the insurer). While there are many forms of risk transfer, the form that this book is mainly concerned with is the traditional insurance policy or contract where an insurer accepts premiums in return for an obligation to pay in the event of a defined event.

1-2:3 Risk Pooling and Risk Prediction

The basic risk transfer insurance business model involves concepts of risk pooling and the prediction of future loss. "Risk pooling" refers to the creation of a large group of similar risks. Pooling similar risks permits a more accurate prediction of future losses. The prediction of future loss is a basic concept in the insurance industry. Insurers must be able to statistically

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19. See Section 1-2:3.

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predict the future in order to price its business to produce enough funds to cover loss, pay for its operating expenses and earn a profit or return.

The larger the pool, the smaller the chance that the loss experience within that pool will be unpredictable. When the sample of exposures is increased in size, the relative variation about the mean declines.[20] Generally, insurance-based risk pooling is most viable when the risks are definable and the probability of payout is known and relatively low.

1-2:4 The Law of Large Numbers

If it were not for the law of large numbers, insurance would not exist. Also known as the "law of averages" the law of large numbers refers to a statistical axiom which states that the larger the number of exposure units independently exposed to loss, the greater the probability that the actual loss experience will equal expected loss experience.[21]

Insurance works through the law of large numbers and the theory that when a pool of similar exposures faces a low-probability event, the proportion experiencing the event will be close to the expected proportion. Insurers use the law of large numbers to estimate future outcomes for planning purposes. It is a key part of prediction. Everything else being equal, the larger the sample size, the lower the relative risk, because prediction rates will be more accurate. In theory, insurers can virtually eliminate an unprofitable risk experience by securing a large enough number of units in an insured group.

The pooling of many exposures gives the insurer a better prediction of future losses. The insurer still has some risk or variability around the average. Nevertheless, the risk of an insurer with more exposures is relatively lower than that of an insurer with fewer exposures under the same expected distribution of losses.

Risks are often not independent and sometimes a cataclysmic event like an earthquake or explosion results in greater than anticipated loss over a short period of time. Therefore, insurers spread such risks not only across individual types of exposures and geography, but also across different years, building reserves to accommodate predicted claim activity. They also diversify across lines of business that will react differently to economic, social and natural perils.

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20. Etti Baranoff, Patrick Lee Brockett and Yehuda Kahane, Risk Management for Enterprises and Individuals (Flat World Knowledge, 2009).

21. See, International Risk Management Institute, Inc. (IRMI) online Insurance Glossary, www.irmi.com.

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1-3 What Risks are Insurable?

Risks that are insurable normally share a number of common characteristics. These characteristics include:

- **The risk must be *Significant or Meaningful*** to an insured, who is willing to pay to reduce or transfer the chance that it occurs. In other words, there must be a value proposition for the payment of premium.
- **The transfer of risk must be *Affordable*.** The price must be an amount that the insured can afford but not so large so that there is no chance of a significant loss to the insurer.[22]
- **The risk must be *Definable*.** The risk must be capable of being defined in a straightforward understandable manner to avoid disputes and support an objective verification that what was intended to be insured actually did occur.
- **The risk must be *Calculable.*** The probability of loss and its cost to the insurer must be able to be calculated.
- **The risk must be *Unintended.*** The risk must occur as a result of unintended actions or caused by unexpected or negligent conduct or events.
- **The risk must be *Assumable.*** The risk must be one that the insurer can assume.

1-4 Insurable Interest Doctrine

1-4:1 Nature of an Insurable Interest

All insurance is based on the concept of wager, the happening of a presently unknown event. That said, courts have developed the doctrine of insurable interest to restrict the wager concept to a socially useful purpose. An insurable interest is the legal right to enter into an insurance contract. A person or entity is said to have an insurable interest if the event insured against could cause that individual a financial loss. An insurable interest, coupled with a valid contract, gives rise to a right of payment for loss resulting from the contingent event.

22. Insurance accounting requires the transfer of significant insurance risk before contracts are considered insurance or reinsurance and to be accounted for as such. *See* FASB #113.

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An insurable interest is defined by:

1. the relationship of the person or entity to the future event causing loss or liability, or
2. the relationship of the risk to the insured.

In New Jersey, insurable interest has been defined by statute to mean "any lawful and substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage."[23] The Supreme Court has formulated a rule that analyzes insurable interest in terms of the reasonable expectations of the insured. The extent of that interest is measured by the "reasonable expectations of the insured," taking into account events subsequent to the time of the loss.[24] Other courts have looked at insurable interest with respect to property, as "'whether the insured has such a right, title or interest therein, or relation thereto, that he will be benefited by its preservation and continued existence or suffer a direct pecuniary loss from its destruction or injury by the peril insured against.'"[25]

The law's requirement that an insured or the beneficiary of the policy have a recognizably defined interest in life or property prevents socially discouraged wagering, arson, or other destruction of property; limits indemnity to actual loss; and reduces potential risk to physical well-being and life.[26] The acid test is whether and to what extent the insured is at financial risk if property is damaged or destroyed, as determined from the facts existing at the time of loss.[27]

1-4:2 Insurable Interest in Property

While an insurable interest in real property has long been recognized in New Jersey,[28] one need not be an absolute owner to have that interest.[29] Insurable interest has been found in property on the basis of equitable

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23. N.J.S.A. 17:37A-8(a)(3).

24. *DeBellis v. Lumbermen's Mut. Cas. Co.,* 77 N.J. 428 (1978).

25. *Hyman v. Sun Ins. Co.,* 70 N.J. Super. 96, 100 (App. Div.1961) (quoting *Farmers Mut. Fire Ins. Co. of Georgia v. Pollock,* 52 Ga. App. 603, 184 S.E. 383 (Ct. App. 1936)).

26. *See Shotmeyer v. N.J. Realty Title Ins. Co.*, 195 N.J. 72 (2008); *Balentine v. N.J. Ins. Underwriting Ass'n*, 406 N.J. Super. 137 (App. Div. 2009) (nominal owner of insured property had an insurable interest in that realty sufficient to recover the proceeds of vandalism insurance policy).

27. *Miller v. N.J. Ins. Underwriting Ass'n*, 188 N.J. Super. 175, 189 (App. Div. 1983).

28. *Sussex County Mut. Ins. Co. v. Woodruff*, 26 N.J.L. 541, 551 (E. & A. 1857) ("It is the general doctrine, 'that any interest in the subject matter insured is sufficient to sustain an insurance of real estate.'").

29. *Hyman v. Sun Ins. Co.*, 70 N.J. Super. 96 (App. Div. 1961).

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title;[30] security interest;[31] trust interest;[32] husband's right of curtesy;[33] inchoate right or interest derived from a tax sale certificate, even though interest in the property does not ripen into ownership until the right of redemption ceases;[34] tenancy;[35] mortgagee, pledgee or other person having a security interest less than complete ownership of the property;[36] possession of premises under a contract for sale;[37] mortgagee in possession by foreclosure or other action;[38] or an owner who has entered into contract for demolition.[39]

Persons who carry on the business of a corporation after the corporate charter has expired or has been revoked become general partners and also continue to have an insurable interest in the earnings of the business and contents of the building, giving a right of recovery under a fire policy.[40] Even the nominal owner of a property may have an insurable interest sufficient to recover the proceeds of an insurance policy.[41]

1-4:3 Insurable Interest in Health and Life Insurance

N.J.S.A. 17B:24-1.1(a) provides that, in addition to the obvious interest in one's own life, body, and health, others may also have an insurable interest in an insured. Other persons include those with an expectation of pecuniary advantage through the continued life and continued health of the insured; those closely related by blood or by law to the insured whose interest is engendered by love and affection; and in corporations, directors,

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30. *Kozlowski v. Pavonia Fire Ins. Co.*, 116 N.J.L. 194 (E. & A. 1936); *Franklin Fire Ins. Co. v. Martin*, 40 N.J.L. 568 (E. & A. 1878) (contract purchaser in possession); *Nieder v. Royal Indem. Ins. Co.,* 62 N.J. 229 (1973).

31. *Flint Frozen Foods, Inc. v. Firemen's Ins. Co. of Newark*, 8 N.J. 606 (1952).

32. *Wiley v. Morris*, 39 N.J. Eq. 97 (Ch. 1884).

33. *Trade Ins. Co. v. Barracliff*, 45 N.J.L. 543 (E. & A. 1883).

34. *Gasorek v. Gruber*, 126 N.J. Super. 511 (App. Div. 1974); *Newark v. Sue Corp*., 124 N.J. Super. 5 (App. Div. 1973); *Manning v. Kasdin*, 97 N.J. Super. 406 (App. Div. 1967).

35. *Nolan v. Firemen's Ins. Co. of Newark*, 7 N.J. Misc. 599 (Sup. Ct. 1929).

36. *Flint Frozen Foods v. Firemen's Ins. Co. of Newark*, 8 N.J. 606 (1952).

37. *Franklin Fire Ins. Co. v. Martin*, 40 N.J.L. 568 (E. & A. 1878) (contract purchaser in possession).

38. *495 Corp. v. N.J. Ins. Underwriting Ass'n*, 173 N.J. Super. 114 (App. Div. 1980), *aff'd*, 86 N.J. 159 (1981).

39. *Tublitz v. Glens Falls Ins. Co.*, 179 N.J. Super. 275 (Law Div. 1981).

40. *Lancellotti v. Md. Cas. Co*., 260 N.J. Super. 579 (App. Div. 1992).

41. *Balentine v. N.J. Ins. Underwriting Ass'n*, 406 N.J. Super. 137 (App. Div. 2009) (a nominal owner listed as an additional insured on a policy was found to have an interest even though the owner did not pay property taxes, insurance premiums, utilities, or other expenses for the premises. He was the owner of record, and was publicly identified as such in the deed books and in the local tax rolls, was responsible for real estate taxes and liable if any occupant or visitor was injured by a dangerous condition on the premises. That was enough to meet the insurable interest test.)

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officers and other key personnel. A beneficiary under a life insurance policy need not have an interest in the insured's life to support an insurance contract and payment of its proceeds.[42]

1-5 Fortuity

The need for fortuity means simply that the nature of the insurance bargain is to exchange a risk of future potential loss for the certainty of a premium. Where the risk of loss has matured into a certainty, there is no more risk to be insured.[43]

1-6 Moral Hazard and Behavior Changes

A moral hazard occurs when the behavior of the insured party changes in a way that raises costs for the insurer, because the insured party no longer bears the risk of the loss. Insurers watch for two types of behavioral changes, or moral hazards. One type is risky behavior itself. Insured parties may behave in a more risky manner, resulting in more negative consequences for which the insurer must pay. For example, after purchasing motor vehicle insurance, insureds may pay less attention to where they park their car, reduce maintenance that could lead to safety issues, or drive faster. After purchasing property insurance, an insured may pay less attention to fire prevention or maintenance around the building.

A second type of behavior that may change is the reaction to the negative consequences of risk. In this case, insured parties do not behave in a more risky manner, but they do act in a way where insurers must pay for more as insurance coverage increases. For example, without medical insurance, some may forego certain medical treatments due to costs and simply deal with substandard health. But after medical insurance becomes available, some may ask an insurance provider to pay for the cost of medical treatment that would not have occurred otherwise.

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42. *Trenton Mut. Life & Fire Ins. Co. v. Johnson*, 24 N.J.L. 576 (Sup. Ct. 1854). *But see*, *Borg v. McCroskery*, 120 N.J. Eq. 80 (Ch. 1936); *Meerwarth v. Meerwarth*, 128 N.J. Super. 285 (Ch. Div. 1974) (former wife entitled to alimony had insurable interest in her ex-husband), *aff'd*, 137 N.J. Super. 66 (App. Div. 1975), *aff'd*, 71 N.J. 541 (1976); *Novern v. John Hancock Mut. Life Ins. Co*., 107 N.J. Super. 570 (Law Div. 1969) (assuming the necessity of an insurable interest and finding it for a divorced wife awarded minor children on whose behalf former husband had been ordered to make regular payments). *See also Thomas v. Nat'l Benefit Ass'n,* 84 N.J.L. 281 (E. & A. 1913) (guardian of orphan) and *Quinn v. Leidinger*, 107 N.J. Eq. 188 (Ch. 1930), *aff'd*, 110 N.J. Eq. 663 (E. & A. 1932).

43. *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.,* 676 F.2d 56, 63 (3d Cir.1982).

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Sometimes a moral hazard is so severe it makes insurance policies impossible. Coinsurance, co-payments and deductibles reduce the risk of moral hazards by increasing the out-of-pocket spending of consumers, which decreases their incentive to consume. Thus, the insureds have a financial incentive to avoid making a claim.

1-7 Underwriting and Pricing Risk

The cost of insurance and the concept of risk are closely related. Price is directly proportionate to the risk of payout. The economic rationale for risk-related pricing in the market is fairly simple and straightforward: higher risks should cost more than lower ones and should contribute to the capital pool in proportion to an expected payout. Risk-related pricing is often tied to historical payouts since past history is often thought to be a good indicator of future activity.

II. REGULATION OF INSURANCE

1-8 Introduction

The insurance industry is subject to various forms of regulation. There are many purposes and objectives for insurance regulation.[44] Principal purposes and objectives include:

1. to maintain the solvency of insurers;
2. to manage the competitive environment;
3. to protect consumers; and
4. to address social concerns.

The "law" of insurance finds its foundation and guidance from three sources (in addition to the policy or contract itself): legislation, administrative regulations or Codes, and case law which is sometimes referred to as "the common law."

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[44] See Section 20, Robert H. Jerry II and Douglas S. Richmond, Understanding Insurance Law (4th Ed. 2007), for a good overview discussion of the rationale for insurance regulation.

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1-9 Regulating 'The Business of Insurance'

What is actually regulated is often referred to as the "business of insurance." The United States Supreme Court has suggested the "business of insurance" must meet a three-part test:

1. The activity involves underwriting or spreading of risk;
2. The activity is an important part of the insurer-insured relationship; and
3. The activity is limited to entities within the insurance industry.[45]

In practical terms, this means that most areas of the business of insurance, are regulated in one way or another, including licensing, taxation, solvency, rates, forms, access and distribution of insurance products and market conduct.

1-9:1 The Power to Regulate Insurance

A basic precept of political life is that if government grants a license to a business activity, it obtains special rights in regulating the organization and activities of that business. To license is to exercise control. Licenses are granted to organizations because of legislative recognition that there is a public right to be protected and that minimum standards must be enforced for the good of those dealing with the organization as well as the good of the general public. For this reason, the insurance industry, a group of competitive organizations with private ownership and market vulnerability, is rigidly regulated.

Because the insurance business is affected with a public interest, it is subject to regulation and control under the state's police power.[46] Insurers may decide not to enter the business arena, but once having undertaken to write insurance coverage, the statutory policy of the state becomes a

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45. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). A contract in which one undertakes to do anything other than to pay a sum of money upon destruction or injury to something in which the other party has an interest is not a contract of insurance. *See Moresh v. O'Regan*, 120 N.J. Eq. 534 (Ch. 1936) (court held a glazer's agreement to be a service contract, and not a contract of insurance, because it did not provide that the glazer would pay money in the event glass was broken or destroyed (specified risks) but, rather, that it would perform labor for payment within a specified period of time), *rev'd on other grounds*, 122 N.J. Eq. 388 (E. & A. 1937).

46. *Howell v. Rosecliff Realty Co., Inc.*, 52 N.J. 313, 318 (1968); *Saffore v. Atl. Cas. Ins. Co.*, 21 N.J. 300, 310 (1956).

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constituent element of insurance contracts. State and federal constitutions are the only power limiting governmental requirements.

It has been stated that in the field of insurance, "the power of the state is broad enough to take over the whole business, leaving no part for private enterprise."[47] Although this may be a bit of hyperbole, our courts have construed the regulatory power of the state over insurers to be extremely broad.[48]

1-9:2 Federal Regulation: McCarran-Ferguson Act

The McCarran–Ferguson Act,[49] is a federal statute that gives states the authority to regulate the "business of insurance" without interference from federal regulation, unless federal law provides otherwise. The Act exempts insurance companies from the federal antitrust legislation that applies to most businesses.

The principal purpose of the Act when it was enacted, was to prefer state over federal regulation of nearly all of the insurance industry. The Act itself states that 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."[50] Prior to *United States v. South-Eastern Underwriters*,[51] insurance contracts were not subject to regulation under the commerce clause of the U.S. Constitution because the law considered insurance contracts not to be articles of commerce, effectively putting them beyond the reach of federal power. Once *United States v. South-Eastern Underwriters* held insurance policies to be articles of commerce, Congress promptly enacted the McCarran-Ferguson Act,[52] stating that it is in the public interest to have the regulation and taxation of the insurance business subject to the laws of the individual states.

The Act provides that state law shall govern the regulation of insurance and that no act of Congress shall invalidate any state law unless the federal law specifically relates to insurance. The Act also states that a federal law

47. *Borland v. Bayonne Hosp.*, 122 N.J. Super. 387, 398 (Ch. Div. 1973), *aff'd*, 136 N.J. Super. 60 (App. Div. 1975), *aff'd*, 72 N.J. 152 (1977), *cert. denied*, 434 U.S. 817 (1977).
48. *See, e.g., Am. Fire & Cas. Co. v. Dep't of Ins.,* 256 N.J. Super. 423 (App. Div. 1992).
49. 15 U.S.C. §§ 1011-1015.
50. 15 U.S.C. §§ 1011-1015.
51. *United States v. South-Eastern Underwriters*, 322 U.S. 533 (1944).
52. 15 U.S.C. §§ 1011-1015.

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that does not specifically regulate the business of insurance does not preempt state laws enacted for that purpose.[53]

The McCarran–Ferguson Act does not define the key phrase "business of insurance," however, as mentioned above the traditional measures focus on transferring risk, part of the relationship between the insurer and the insured, and entities within the insurance industry.[54]

1-10 Regulation of Insurance in New Jersey

1-10:1 Introduction: New Jersey Insurance Legislation and Administrative Regulations

The bulk of enacted laws governing the insurance industry in New Jersey are found in Titles 17 and 39.[55] Insurance Administrative Regulations are found in Title 11.

The Department of Banking and Insurance regulates the banking, insurance and real estate industries, protects and educates consumers and promotes the growth, financial stability and efficiency of those industries.[56] The Department of Banking and Insurance is comprised of three main units-the Division of Banking, the Division of Insurance and the New Jersey Real Estate Commission and is headed by the Commissioner of Banking and Insurance.

The Division of Insurance is charged with the licensing and oversight of all types of insurance regulated by the State of New Jersey. The Division of Insurance issues licenses to insurance companies, producers and other risk-assuming entities, reviews insurance products and rates for compliance with existing regulations, and monitors the financial solvency of licensees to ensure product availability in the marketplace. The Division also

53. A state law has the purpose of regulating the insurance industry if it has the "end, intention or aim of adjusting, managing, or controlling the business of insurance." *United States Dep't of Treasury v. Fabe,* 508 U.S. 491 (1993).

54. McCarran-Ferguson does not prevent the federal government from regulating the insurance industry. It provides only that states have broad authority to regulate the insurance industry unless the federal government enacts legislation specifically intended to do so. McCarran-Ferguson also provides that the Sherman Anti-Trust Act of 1890, 15 U.S.C. § 1 et seq., the Clayton Anti-Trust Act of 1914, 15 U.S.C. § 12 et seq., and the Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41-51, apply to the business of insurance to the extent that such business is not regulated by state law.

55. See Robert Ramsey, New Jersey Insurance Codes Annotated (West 2009), which presents New Jersey Insurance statutes along with references to leading cases.

56. *See* New Jersey Department of Banking and Insurance website, http://www.state.nj.us/dobi/index.html.

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responds to consumer concerns and inquiries and endeavors to educate consumers regarding insurance products and issues.[57]

1-10:2 Application to Executive Branch: Administrative Regulations

Where a legislative body establishes basic policy in its enabling statute, it may grant broad authority to an administrative agency to make rules and regulations necessary to implement those policies. Such a grant of authority is liberally construed to enable the agency to accomplish its statutory responsibilities, and courts imply such incidental powers as are necessary to fully implement the legislative intent.[58] Administrative agency actions are presumed to be valid if they are within the statutory authority delegated to the agency. The burden is on the party challenging the agency action to overcome this presumption.[59]

Regulations promulgated by the Commissioner of Insurance are presumptively valid.[60] The Commissioner of Insurance, however, is bound by the statutory intent and if that department acts contrary to an evident statutory meaning, a history of administrative judgment will not save an administrative interpretation of the statute from being struck down.[61]

The commissioner must follow the appropriate rule-making procedures when acting in an administrative capacity.[62]

If the Commissioner of Insurance approves policy forms or endorsements that violate statutory intent, the Commissioner is subject to the same review and restrictions by the court as are insurers. However, administrative regulations are accorded a strong presumption of validity

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57. *See* New Jersey Department of Banking and Insurance website, http://www.state.nj.us/dobi/index.html.

58. *Coal. for Quality Health Care v. N.J. Dep't of Banking & Ins.*, 348 N.J. Super. 272, 294-95 (App. Div. 2002); *New Jersey Healthcare Coal. v. N.J. Dep't of Banking & Ins.*, 440 N.J. Super. 129 (App. Div. 2015) (upholding regulatory changes as to personal injury protection benefits including scope of reimbursements to PIP medical providers and establishing a process for awarding reasonable attorney's fees).

59. *Coal. for Quality Health Care v. N.J. Dep't of Banking & Ins.*, 348 N.J. Super. 272, 301 (App. Div. 2002); *New Jersey Healthcare Coal. v. N.J. Dep't of Banking & Ins.*, 440 N.J. Super. 129 (App. Div. 2015) (upholding regulatory changes as to personal injury protection benefits including scope of reimbursements to PIP medical providers and establishing a process for awarding reasonable attorney's fees).

60. *Med. Soc'y v. N.J. Dep't of Law & Pub. Safety*, 120 N.J. 18, 25 (1990); *Ingersoll v. Aetna Cas. & Sur. Co.*, 269 N.J. Super. 192, 197 (App. Div. 1993), *rev'd on other grounds*, 138 N.J. 236 (1994).

61. *In re Comm'r of Ins. March 24 1992 Order*, 256 N.J. Super. 158 (App. Div. 1992), *aff'd*, 132 N.J. 209 (1993).

62. *In re Comm'r of Ins. March 24 1992 Order*, 256 N.J. Super. 158 (App. Div. 1992), *aff'd*, 132 N.J. 209 (1993).

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and reasonableness. The party attacking an administrative regulation must demonstrate that it is arbitrary, capricious, or otherwise unreasonable. Because of the rebuttable presumption afforded administrative regulations, an *ultra vires* finding, or judgment that the exercised authority was beyond the power granted, generally is disfavored. In deciding whether an administrative regulation is authorized by statute, the reviewing court may look beyond the specific terms of the enabling act to the desired statutory policy and examine the language in light of its objectives.

A court may not substitute its judgment as to the wisdom of an administrative action for the judgment of the agency as long as the agency's action is statutorily authorized and is reasonable. If any fair argument will support the Commissioner's action or if there is any reasonable ground for the agency's position, it will not be disturbed unless patently corrupt, arbitrary, or illegal.

The construction of a regulatory statute by the agency charged with its enforcement is given great weight by the court and is a substantial factor in a court's construction. The Commissioner's expertise in the field of insurance must be given great weight.[63]

Although courts afford substantial deference to an administrative agency's interpretation of a statute, they are not bound by that interpretation or the agency's determination of strictly legal issues. Construction of a statute is a judicial and not an executive function. When the executive or administrative interpretation is clearly contrary to the plain meaning of the statute, the court has the obligation to override the administrative determination.[64]

There are, however, limits to the authority of the commissioner to impose obligations on insurers.[65]

1-10:3 State Control of Insurers

An illustration of the tight control that can be constitutionally exercised by the state is evident in *Sheeran v. Nationwide Mutual Insurance Company, Inc.*[66] Nationwide contended that the statute, which prevented it from

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63. *In re Comm'r of Ins. Issuance of Orders A-92-189 and A-92-212*, 274 N.J. Super. 385, 397-98 (App. Div. 1993) (holding that the Commissioner of Insurance did not exceed his authority in promulgating a regulation under N.J.S.A. 17:29A-5.6 to 5.16, intended to implement the Fair Automobile Insurance Reform Act [FAIR] of 1990, N.J.S.A. 17:33B-1 to 62), *aff'd*, 137 N.J. 93 (1994).

64. *Chubb Group v. Trenton Bd. of Educ.*, 304 N.J. Super. 10, 14 (App. Div. 1997).

65. *In re Comm'r of Ins. March 24 1992 Order*, 256 N.J. Super. 158 (App. Div. 1992), *aff'd*, 132 N.J. 209 (1993) (Commissioner held to lack authority to impose transitional assessments under the Fair Automobile Insurance Reform Act (FAIR)).

66. *Sheeran v. Nationwide Mut. Ins. Co., Inc.*, 80 N.J. 548 (1979). Interestingly, *Sheeran* has been subsequently cited as frequently by dissenting Justices, chiding the majority for failure to follow the mandate of statutory language and reminding the majority that "a Court should enforce the statute

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refusing renewal of coverage under the No-Fault Act without the consent of the Commissioner of Insurance, was unconstitutional. It argued on the grounds that it (a) was an undue delegation of legislative authority, (b) deprived the insurer of its property without due process of law, and (c) forced compliance with a statutory scheme not rationally related to its business because of the unconstitutional condition imposed on it. The Court, after answering each of Nationwide's arguments, concluded that to retain its license to sell automobile insurance within New Jersey it must obey the requirements of the Act.

1-10:4 Legislative Leeway

The equal protection clause of the 14th Amendment, as well as equal protection guarantees in the New Jersey state constitution, require that persons similarly situated be treated alike. These guarantees do not, however, require the government to treat all persons identically. The legislature has leeway in making rational classifications based on policy considerations, the wisdom of which is not to be questioned by the courts.[67] Ultimately, courts must determine whether the classifications drawn in a statute are reasonable in light of the legislature's purpose.[68] In construing an insurance statute, the courts will consider legislative language "sensibly rather than literally" and presume that the controlling legislative intent is "consonant to reason and good discretion."[69]

1-10:5 Presumption of Validity

If an insurer challenges a statute as unconstitutional on the ground that a legislatively created distinction bears no rational relation to the legislature's purpose, it shoulders a heavy burden. The insurer must (a) overcome a strong presumption of legislative validity,[70] and (b) it must

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according to its terms." *In re Exec. Comm'n on Ethical Standards*, 116 N.J. 216, 227-29 (1989). Judicial interpretation is inappropriate even if a particular application of the law was not foreseen by its drafters. *See, e.g., In re Exec. Comm'n on Ethical Standards*, 116 N.J. 216, 227-29 (1989).

[67] *ADA Fin. Serv. Corp. v. New Jersey*, 174 N.J. Super. 337 (App. Div. 1979).

[68] *McLaughlin v. Florida*, 379 U.S. 184, 191 (1964); *see also Group Health Ins. of N.J. v. Howell*, 43 N.J. 104 (1964).

[69] *Flaherty v. The Enclave*, 255 N.J. Super. 407, 411 (Law Div. 1992); *see also Relly v. AAA Mid-Atlantic Ins.*, 194 N.J. 474 (2008) (the Court held that for purposes of assessing insurance eligibility rating points, the Department of Banking & Insurance improperly utilized an underwriting analysis rather than negligence-based fault concepts to assess the culpability of a driver for an "at-fault accident," the determination of which would have a serious impact on the driver's ability to obtain insurance with a premium rating that truly reflected his conscientiousness and caution as an automobile driver).

[70] *Hutton Park Gardens v. W. Orange*, 68 N.J. 543, 564-65 (1975).

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show that the statutory classification has no reasonable basis. If these two hurdles can be crossed, the insurer may sustain a contention that the statute unlawfully discriminates against it.[71]

1-10:6 The Insurance Trade Practices Act

The New Jersey Legislature has defined the relationship between insurance companies and insureds by promulgating a broad range of statutory provisions. The Insurance Trade Practices Act ("ITPA") was enacted to regulate trade practices in the business of insurance.[72] The Act defines and prohibits "certain abuses in the insurance business and empower[s] the Commissioner of Banking and Insurance of [New Jersey] to deal with them."[73] The unfair practices defined and prohibited include "Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear."[74]

The Commissioner of Insurance is accorded broad power under the ITPA. Allegations that a person is misleading, misrepresenting or conveying false statements regarding insurance policies are investigated and resolved by the Commissioner.[75] It is the Commissioner who determines whether an insurance company is "engaged in a method of unfair competition or unfair deceptive practice . . . ." [76] Decisions of the Commissioner are subject to review by the New Jersey Superior Court.[77] The ITPA, which is a penal statute, has strictly been construed by the New Jersey courts.[78]

No individual or private right of action exists under the ITPA.[79] The New Jersey Legislature has adopted a method for deterring unfair insurance practices under N.J.S.A. 17:29B-1 et seq. N.J.S.A. 17:29B-4(9)(d) declares that the general business practice of an insurance company of "[r]efusing

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71. *Morgan v. Orcinoli*, 183 N.J. Super. 338 (Law Div. 1981).

72. N.J.S.A. 17:29 B-1; *see* Chapter 5, Section 5-6:1.

73. *Retail Clerks Welfare Fund, Local 1049, AFL-CIO v. Cont'l Cas. Co.,* 71 N.J. Super. 221, 225 (App. Div.1961).

74. *Retail Clerks Welfare Fund, Local 1049, AFL-CIO v. Cont'l Cas. Co.,* 71 N.J. Super. 221, 225 (App. Div. 1961).

75. N.J.S.A. 17:29B-4 to 17:29B-7.

76. *Chick's Auto Body v. State Farm Ins. Co.,* 168 N.J. Super. 68, 82 (Law Div. 1979), *aff'd,* 176 N.J. Super. 320 (App. Div. 1980).

77. N.J.S.A. 17:29B-8.

78. *See Retail Clerks Welfare Fund, Local 1049, AFL-CIO v. Cont'l Cas. Co.,* 71 N.J. Super. 221, 225 (App. Div.1961).

79. *Pierzga v. Ohio Cas. Grp. of Ins. Cos.,* 208 N.J. Super. 40, 47 (App. Div. 1986); *Milcarek v. Nationwide Ins. Co.,* 190 N.J. Super. 358 (App. Div. 1983); *Kubiak v. Allstate Ins. Co.,* 198 N.J. Super. 115 (App. Div. 1984); *Chick's Auto Body v. State Farm Ins. Co.,* 168 N.J. Super. 68, 82 (Law Div. 1979), *aff'd,* 176 N.J. Super. 320 (App. Div. 1980).

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to pay claims without conducting a reasonable investigation based upon all available information" is an unfair claim-settlement practice. Of course, such alleged violations are resolved before the Commissioner of Insurance and the monetary penalty provided would not go to the parties aggrieved by the insurer's actions.[80] Nevertheless, this act punishes insurance companies for unreasonably denying claims, thereby also serving as a deterrent. In order for an individual to pursue a claim under the ITPA, they must first file a complaint with the Commissioner.[81]

1-10:7 Judicial Regulation

Despite the number of statutes and regulations enacted in New Jersey to govern the insurance industry, perhaps the greatest impact and governance comes from the case law published by all levels of state courts addressing insurers, insurance policies, enacted statutes and regulations. The body of case law is immense and ever expanding. Many of the remaining chapters in this book focus on that body of governing law, from policy and statutory interpretation to public policy concerns and specific areas of insurance coverage.

III. TYPES AND LINES OF INSURANCE PRODUCTS AND POLICIES

1-11 Introduction

Any attempt to present a list of, much less discuss, all the different types of insurance policies and products is difficult because there are so many categories and branches of insurance and a multitude of insurance products. That said, insurance products (and insurers) may be grouped into several categories. Below is a snapshot of these categories with brief explanations and discussions. Many of the most common types of policies are discussed in detail in specific chapters and sections of this book.

1-11:1 Proving Missing or Lost Policies of Insurance

There are various ways that a policyholder who claims coverage under a missing or lost policy can prove the policy. The insured can seek to locate

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80. N.J.S.A. 17:29B-5, N.J.S.A. 17:29B-6 and N.J.S.A. 17:29B-7*; see also Milcarek v. Nationwide Ins. Co.,* 190 N.J. Super. 358, 368 (App. Div. 1983).

81. *Weiss v. First Unum Life Ins. Co.,* 482 F.3d 254, 264 (3d Cir. 2007).

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the policy through institutional policy archeology. If this is not successful, and the policyholder is unable to locate a complete policy through diligent search, components of the policy or information as to critical and necessary coverage provisions may be proved through other means as, for example, through a policy reconstruction expert.

If the insured cannot furnish the original policy, the New Jersey Rules of Evidence, patterned after the Federal Rules of Evidence, provide that secondary evidence may be used to establish the existence of the original document, assuming that the policyholder has not acted in bad faith and a diligent search for the original has proven unsuccessful.[82]

Various documents, including a declarations page or a partial policy,[83] broker documents, premium notices,[84] policyholder documents such as Board of Directors' meeting minutes[85] and corroborating testimony from an insured's employee have all been recognized as evidential to prove the existence and contents of the claimed policy. The policy in question may be proven by such secondary evidence if the policy holder cannot reconstruct the actual language of the policy,[86] especially when the policy, itself, is one of common forms drafted by the ISO and adopted throughout the industry. These methods of establishing coverage under a missing or lost policy have been upheld in other jurisdictions.[87]

In New Jersey, there is presently only one reported case which addresses the missing/lost policy issue.[88] In *Sayreville*, the issue presented was the quantum of proof necessary to establish the existence and contents of missing liability insurance policies. The Borough of Sayreville maintained various comprehensive general liability insurance policies, primary and excess, with numerous carriers during the period it operated a municipal landfill. Eventually, the Borough was directed by the New Jersey DEP and U.S. EPA to perform various remediation and monitoring tasks at the landfill. Sayreville instituted an action against all of the carriers on the risk during the years the Borough had used the landfill as a solid waste

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82. N.J.R.E. 1004; Fed. R. Evid. 1004.

83. *Century Indem. Co. v. Aero-Motive Co.,* 254 F. Supp. 2d 670 (W.D. Mich. 2003).

84. *MAPCO Alaska Petrol., Inc. v. Central Nat'l Ins. Co.*, 795 F. Supp. 941 (D. Alaska 1991).

85. *Burroughs Wellcome Co. v. Commercial Union Ins. Co.*, 632 F. Supp. 1213, *modified*, 642 F. Supp. 1020 (S.D.N.Y. 1986).

86. *Dart Indus. Inc. v. Commercial Union Ins. Co*., 28 Cal. 4th 1059, 52 P.3d 79 (Cal. 2002).

87. Michael S. Jones, *Insurance Law Annual: No Policy, No Problem? How Insureds Are Finding Coverage Even Though They Can't Find Their Policies*, 50 Drake L. Rev. 611 (2002).

88. *Borough of Sayreville v. Bellefonte Ins. Co*., 320 N.J. Super. 598 (App. Div. 1998).

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site. The trial judge denied coverage, finding that the Borough had failed in its burden to produce those policies or establish their terms by clear and convincing evidence. The Appellate Division reversed and remanded the case for discovery consistent with a preponderance of the evidence standard as to the missing policies.

The appellate court acknowledged that, although other jurisdictions were split between the clear and convincing standard and the preponderance of the evidence standard in establishing policies, the more recent cases had applied the preponderance standard to missing policies. Therefore, it adopted that preponderance standard in the absence of any claim of fraud.

In *Sayreville*, the Borough was able to provide copies of insurance schedules by number, type, applicable limits and dates of coverage and, although admittedly incomplete, minutes from Borough meetings indicating that, in fact, the insurer's CGL policies were in effect during the contested period. Based on this evidence, the court concluded that sufficient evidence existed to suggest a prima facie case under the preponderance of evidence standard.

1-12 Life and Non-Life Categories of Insurance

Insurance companies and policies are often split into the life and non-life categories. Life means traditional life insurance as well as accident and health, disability and pension products. Non-life refers to most other lines of general insurance. Life and non-life products and insurers are subject to different regulations, tax and accounting rules.

A principal difference between the life and non-life categories is the length of time for which the products are written. Life products tend to be written for long periods of time, sometimes decades or longer where non-life products are issued for shorter time periods. Solvency and other concerns that arise based on the long time periods involved for life products subjects them to different regulatory and accounting rules in many jurisdictions.

A second difference is that a greater degree of certainty surrounds many life products. There is certainty that the insured will either die or surrender the policy, the face amount of the worst case scenario is known and life insurers can use mortality tables and lapse statistics to predict future events with a good degree of accuracy. It is much more difficult to predict losses under non-life policies. There is a large range of possible losses between zero and the policy limit that can occur during any policy period.

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Many insurers sell both life and non life insurance and many lines of business within each category. Sometimes these companies are referred to as multiline insurers. An insurer that writes just one type of insurance is sometimes referred to as a monoline insurer.[89]

1-13 Personal, Consumer and Commercial Lines

Insurance policies are also grouped by customer. The usual designations are personal or consumer lines and commercial lines. Personal insurance policies are often standard forms and are regulated to a higher degree based on a desire to protect the consumer. Commercial policies are usually more complex and sometimes include manuscript language, meaning that the wording was drafted particularly for or by the insured.

1-14 First-Party and Third-Party Insurance

Insurance products are also commonly categorized as first-party insurance and third-party insurance. First-party insurance pays the insured itself for losses to its own property or consequential losses arising out of losses or damage to that party.[90] The most prevalent type of first-party insurance is property insurance, which pays the owner for losses and damages to real or personal property.

Third-party or liability insurance covers the insured for injury or damage caused by the insured's conduct to third parties.

1-15 Specific Types of Insurance

1-15:1 Overview

While the rest of this book discusses many policies and products in more detail and in the context of what New Jersey law has to say about them, the following is an overall summary of the many different types of insurance policies and products.

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[89] *See* IRMI online insurance glossary, http://www.irmi.com/online/insurance-glossary/terms/m/monoline.aspx.

[90] See Chapter 20, Property Insurance and Fire Insurance.

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1-16 Life Insurance and Other Life Products

Three of the most common types of life insurance products are traditional life insurance, annuities, and health and disability insurance. Traditional life insurance provides coverage for death and is usually purchased to protect against an untimely one. Annuities provide a guaranteed payment for a period of time, often the remaining life of the insured.

Traditional life insurance provides coverage after the insured party's death, often to a family member(s) left behind, known as the beneficiary. Term life insurance is sold for a specified time period. Whole life insurance provides coverage throughout the insured's life and sometimes also serves as an investment vehicle developing cash value over time.

Health insurance takes many forms and is used primarily to pay for expenses incurred for private medical treatment and hospital stays. Many employers provide health insurance benefit packages.

Disability insurance provides financial support when the insured becomes unable to work due to illness or injury during the policy period. There are various forms of disability insurance that provide monthly payments when an insured is temporarily or permanently disabled.[91]

1-17 Property Insurance

Property insurance is first-party coverage based on a contract in which the insurer assumes particular risks of the other party and promises to pay a fixed or calculable sum of money based on a specified contingency.[92] Property insurance normally provides coverage for loss of both real property (buildings and fixtures) and moveable property (personal property, goods in transit, etc.). Popular forms of property insurance include:

Fire Insurance

Commercial Property Insurance

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91. *See Dittmar v. Cont'l Cas. Co.*, 29 N.J. 532 (1959).

92. *Moresh v. O'Regan*, 120 N.J. Eq. 534 (Ch. 1936) (the issue was whether a company was engaged in providing insurance: for a sum certain, a glazing business would repair and replace customers' glass storefronts. The court held the glazer's agreement to be a service contract, and not a contract of insurance, because it did not provide that the glazer would pay money in the event glass was broken or destroyed (specified risks) but, rather, that it would perform labor for payment within a specified period of time), *rev'd on other grounds*, 122 N.J. Eq. 388 (E. & A. 1937).

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Boiler and Machinery Insurance[93]

Debris Removal Insurance[94]

Builder's Risk Insurance[95]

Glass Insurance[96]

Marine Insurance[97]

Business Interruption Insurance[98]

Ordinance or Law Insurance[99]

Tenant's

Insurance[100]

1-18 Liability Insurance

Liability insurance covers injuries for losses arising out of legal liability to others caused by the conduct of the insured. Popular forms of liability insurance include:

General Liability Insurance[101]

Errors and Omissions or Malpractice Insurance[102]

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93. Boiler and machinery insurance, sometimes referred to as "equipment breakdown" or "mechanical breakdown coverage," provides coverage for the accidental breakdown of boilers, machinery, and equipment.

94. Debris removal insurance covers the cost of removing debris after a significant event like an explosion, fire, flood or hurricane.

95. Builder's risk insurance covers buildings while they are being constructed.

96. Glass insurance covers broken store windows and plate glass windows.

97. Goods in transit and mobile property are usually covered by some type of property transportation insurance often referred to as Marine insurance. Marine insurance is broken down into Ocean Marine and Inland Marine. Ocean Marine Insurance is used to cover ships and cargo in transit. This coverage usually has four separate coverage grants: hull, cargo, freight (loss of income from lost cargo) and liability. Inland Marine Insurance covers property in transit and other people's property on insured's premises. *See Arrow Indus. Carriers v. Cont'l*, 232 N.J. Super. 324 (Law Div. 1989).

98. Business interruption insurance covers lost income and expenses resulting from property damage or loss.

99. Ordinance or law insurance covers the costs associated with having to demolish and rebuild to code when a building has been damaged as a result of a covered peril.

100. Real Property leases often require tenants to carry a certain amount of insurance. A renter's commercial policy covers damages to the tenant's property, improvements made to rental space, and for damages caused by the negligence of the tenant.

101. See Chapter 12 for a discussion of commercial general liability policies.

102. Errors and omissions ("E & O") insurance covers negligent acts, mistakes or failure by the insured that cause injury to a third party. The coverage is often purchased by "professionals." See Chapter 17 for a discussion of professional liability policies.

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Directors' and Officers' Liability Insurance[103]

Automobile Insurance[104]

Homeowner Insurance [105]

Workers' Compensation Insurance[106]

1-19 Other Types of Insurance

There are other insurance products that for one reason or another are usually discussed separately from life, property or liability insurance.

1-19:1 Financial Guaranty

Financial guaranty insurance refers to bonds, insurance policies, indemnity contracts or other guarantees under which loss is payable after the occurrence of covered financial loss to an insured claimant, obligee or indemnitee.

Financial guaranty insurance covers lenders from liability resulting from the failure of a borrower to repay a loan. Financial guaranty insurance may also cover losses from a decrease in interest rates to the detriment of the lender. Financial guarantee insurance may cover different types of loans and is similar to a surety or a co-signed loan.

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103. This type of insurance is generally purchased by corporations and nonprofit organizations to cover the costs of lawsuits against directors and officers. See Chapter 17 for a discussion of professional liability policies.

104. Automobile Insurance contains both first- and third-party components and provides coverage for automobile accidents and damage to the insured's automobile. The liability portion covers damages when the insured driver's conduct injures someone or damages property in an accident arising out of or in the course of using a motor vehicle. The first-party cover includes collision and comprehensive coverage. Collision insurance pays for damage to the insured automobile when it is involved in a collision. Comprehensive insurance covers damage to the insured automobile resulting from causes other than collision, like hail, a rock through a windshield, or vandalism. See Chapters 13 (automobile policies), 14 (personal injury protection coverage) and 15 (uninsured motorist and underinsured motorist coverage).

105. Homeowner insurance also contains both first- and third-party components and provides coverage for losses due to damage or destruction of a home as well as liability coverage under a number of scenarios when a third party is injured as a result of the insured's negligence. See Chapter 16 for further discussion.

106. Workers' compensation insurance covers employers for employee's injuries arising out of and in the course of employment. Most, if not all, states require businesses with more than a certain number of employees to purchase some type of workers' compensation insurance. In most cases, workers' compensation laws prohibit injured employees from bringing a negligence lawsuit against an employer for work-related injuries. See Chapter 19 for further discussion.

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1-19:2 Bonds, Fidelity and Crime Insurance

Bonding and fidelity insurance are forms of financial guaranty coverage designed to address human performance or indemnity obligations when a party fails to perform or acts fraudulently. Bonds are contracts where the insurer (surety) agrees to provide payment to another (obligee) if the obligee is injured by the acts of a third party (principal or employee). Surety bonds guaranty the performance of a non-employee principal.[107] Fidelity bonds guaranty the performance or more particularly against the fraudulent acts of employees or a fiduciary. Other types of bonds include judicial bonds and public official bonds.[108]

Crime insurance is similar to a fidelity bond except that crime policies provide coverage for loss caused by the fraudulent conduct or an unrelated third party, not an employee.

The differences betweens bonds and traditional insurance are twofold. First, while insurance usually is a contract between two parties, bonds involve three parties, the surety, the obligee and the principal. Second, under most bonds the insurer can seek reimbursement from the principal (in essence its own insured) after a guaranteed payment is made if the principal's conduct contributed to causing the loss to the obligee.

1-20 Title Insurance

Title insurance protects a buyer or owner of real estate in the event that the seller did not have a clear title to that property. It protects the insured against financial loss from defects in title to real property and from the invalidity or unenforceability of a mortgage lien. Given the unequal bargaining power between the parties to a title insurance contract, our courts have consistently treated such policies as contracts of adhesion.[109] As a result, any ambiguity in the terms of a title policy will be construed against the insurer and in favor of the insured.[110] Exceptions to

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107. A surety bond is a specific type of bond which involves three different parties. The first party is the principal, the person or organization who is being secured against default. The second party is the obligee, the person or organization who is owed money or labor. The third party is the surety, the person or organization who is promising to pay a certain amount should the principal default.

108. To protect the interests of taxpayers and consumers, many public officials are required to be bonded by statute or ordinance. A public official bond guarantees that a public official will handle money or other assets with honesty and/or may also guarantee that the official faithfully performs his or her duties.

109. *Amidano v. Donnelly*, 260 N.J. Super. 148, 154 (App. Div. 1992), *cert. denied*, 133 N.J. 435 (1993).

110. *Fortunato v. Highlands Ins. Grp.*, 345 N.J. Super. 529 (Law Div. 2001).

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coverage are construed strictly against the insurer.[111] When there is ambiguity, courts will interpret policy language to comport with the reasonable expectations of an insured even if a close reading of the written text might reveal a contrary meaning.[112]

In its simplest form, a title insurance policy is a contract of indemnity under which the insurer for valuable consideration agrees to indemnify the insured in a specified amount against loss through defects of title to, or liens or encumbrances upon, realty in which the insured has an interest.[113] Because a title insurance policy is an indemnity policy, both pursuant to the explicit terms of the policy and under New Jersey law, an insurer's refusal to provide coverage for a valid claim constitutes breach of the policy that entitles the insured to payment of attorney fees and costs which accrue as a result of necessary litigation against the insurer.[114]

Another basic question is whether issuance of the title commitment and policy places a duty on the insurer to search for and disclose to the insured any reasonably discoverable information that would affect the insured's decision to close the contract of purchase. The rule is that a title insurer's liability is limited to the policy and the insurer is not liable in tort for negligence of another in searching records. Underlying that rule is the premise that the duty of the title insurer, unlike the duty of a title searcher, does not depend on negligence but on the agreement between the parties.[115] If, however, the title insurer agrees to conduct a search and provide the insured with an abstract of title in addition to the title policy, it may expose itself to liability for negligence as a title searcher, as well as for liability under the policy.[116]

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111. *Amidano v. Donnelly*, 260 N.J. Super. 148, at 154 (App. Div. 1992). *See also Walker Rogge Inc. v. Chelsea Title & Guar. Co*., 116 N.J. 517, 529 (1989).

112. *Zacarias v. Allstate Ins. Co.*, 168 N.J. 590, 595 (2001).

113. *Sandler v. N.J. Realty Title Ins. Co.*, 36 N.J. 471, 478-79 (1962).

114. *Sandler v. N.J. Realty Title Ins. Co*, 36 N.J. 471, at 478-79 (1962) ("A title insurance policy is a contract of indemnity under which the insurer for a valuable consideration agrees to indemnify the insured in a specified amount against loss through defects of title to, or liens or encumbrances upon, realty in which the insured has an interest").

115. *Booth v. N.J. Highway Auth.*, 60 N.J. Super. 534 (Law Div. 1960). *See also Caravan Prods. Co. v. Ritchie*, 55 N.J. 71, 74 (1969) (Under a title policy, "the liability of [the insured] is contractual and does not depend on negligence"); *Enright v. Lubow,* 202 N.J. Super. 58, 67 (App. Div. 1985) (the contractual "nature of a title insurance policy and a title report" precludes negligence liability).

116. *Trenton Pottery's Co. v. Title Guar. & Trust Co.*, 176 N.Y. 65, 68 N.E. 132, 135 (1903).

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1-21 Political Risk Insurance

Political risk insurance (PRI) protects the insured against a number of specific perils usually associated with losses arising out of a country's social or political disruption caused by sovereign governments. PRI also can serve as a loss control or mitigation tool to encourage investment in a project in an undeveloped or "third world" country.

Political risk insurance is available for many types of perils including:

1. Political violence, such as revolution, insurrection, civil unrest, terrorism or war;
2. Governmental expropriation, nationalization, deprivation or confiscation of assets;
3. Non-honoring of promissory notes, letters of credit, or sovereign guarantee;
4. License cancellation or embargo;
5. Governmental frustration or repudiation of contracts;
6. Inconvertibility of foreign currency or the inability to repatriate funds;
7. Business interruption; or
8. Non-honoring of arbitration award.

Political risk insurance can insure assets like mines, factories, buildings, natural resources and inventory stored in a foreign country. It can insure trade transactions and infrastructure projects. It can insure loans and other collateral or investment. And it can insure sovereign government performance such as non-honoring of sovereign payment obligations and guarantees, wrongful calling of performance bonds, down-payment guarantees, milestone payment guarantees, or letters of credit.

1-22 Social Insurance

Social insurance includes protection of individuals against economic hazards such as unemployment, old age, or disability. Principal social insurance schemes include:

a. Medicare—a United States government program of medical care for the aged, and

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b. Social Security—a United States government program that provides retirement income, health care for the aged, and disability coverage for eligible workers and their dependents.

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