

**Chapter 5**  
**Fundamental Legal Principles of Insurance Contract**

**QUESTION one ( Multiple choice)**

1- Fundamental purposes of the principle of indemnity include which of the following?

- I- To reduce physical hazards
- II- To prevent the insured from profiting insurance

- a) I only      b) II only      c) Both I and II      d) Neither I nor II

Answer

2- Which of the following is a fundamental purpose of the principle of indemnity?

- a) To reduce moral hazard
- b) To minimize physical hazards
- c) To settle property insurance losses on a replacement cost basis
- d) To require deductibles in all property insurance policies

Answer

3- Samy's stereo was destroyed in a fire. The stereo cost \$1200 when it was purchased ,but a similar new stereo now \$1800 . assuming the stereo was 50 percent depreciated , what is the actual cash value of Samy's stereo

- a) \$600
- b) \$900
- c) \$1200
- d) \$1800

Answer

4- All of the following are exceptions to the principle of indemnity except

- a) Life insurance
- b) Valued policies
- c) Replacement cost property insurance
- d) Actual cash value property insurance

Answer

5- Under which of the following rules is actual cash value determined by taking into consideration all relevant factors an expert would use to determine the value of the property?

- a) the circumstantial evidence rule
- b) the broad evidence rule

- c) the property indemnity rule
- d) the objective value rule

Answer

- 6- a total loss under a valued policy is settled on the basis on the basis of the
- a) market value of the loss
  - b) actual value of the basis
  - c) replacement value of the loss
  - d) amount of insurance covering the loss

Answer

- 7- Which of the following statements describes the effect of a property insurance policy being written on a replacement cost basis?
- a) Losses are settled without the applicable deductible
  - b) Losses are settled without a deduction for depreciation
  - c) The insurer must replace the damaged or destroyed property in lieu of a cash settlement
  - d) The policy is converted to a valued policy

Answer

- 8- Which of the following statements about the principle of insurable interest is (are) true?
- i- It makes it difficult to measure the amount of an insured's loss
  - ii- It reduces moral hazard
- a) I only      b) II only      c) Both I and II      d) Neither I nor II

Answer

- 9- All of the following will support an insurable interest for purposes of purchasing property and liability insurance Except
- a) Ties of blood and marriage
  - b) Potential legal liability
  - c) A creditor- debtor relationship
  - d) A contract right

Answer

- 10- Which of the following statements about an insurable interest in life insurance is (are) true?

- I- It is required of any person named as beneficiary
- II- It may result from a pecuniary (financial) interest ,even if there is no relationship by marriage or blood

a) I only      b) II only      c) Both I and II      d) Neither I nor II

Answer

11- When must an insurable interest legally exist in life insurance?

- a) Only at the time of death
- b) Only at the inception of policy
- c) Only at the time the beneficiary is paid
- d) Both at the time of death and at the inception of policy

Answer

12- When must an insurable interest legally exist in property insurance?

- a) Only at the time of loss
- b) Only at the inception of policy
- c) Only at the time of loss settlement process takes place
- d) Both at the time of death and at the inception of policy

Answer

13- Suzan's office building was damaged by a fire caused by a careless tenant. After paying Suzan for her loss, the insurance company sued the tenant to recover its loss. This suit is based on the principle of

- a) Indemnity
- b) Insurable interest
- c) Utmost good faith
- d) Subrogation

Answer

14- All of the following are basic purposes of subrogation Except

- a) To eliminate adverse selection
- b) To hold down the cost of insurance
- c) To prevent an insured from collecting twice for the same loss
- d) To hold the negligent person responsible for a loss

Answer

- 15- Which of the following statements about Subrogation is true?
- a) It is used primarily for losses paid under life insurance policies
  - b) It allows the insurer to sue its own insured who is negligent
  - c) The insured's rights to collect benefits may be forfeited if insured interferes with the insurer's rights after a loss
  - d) The insurer is required to exercise its subrogation rights

Answer

- 16- The principle of utmost good faith is supported by all of the following legal doctrines Except
- a) Representations
  - b) Warranty
  - c) Subrogation
  - d) Concealment

Answer

- 17- What is the legal significance of material concealment by an insurance applicant?
- a) The contract is automatically voided from its inception
  - b) The contract is avoidable at the insurer's option
  - c) Loss payments are reduced by the degree of the concealment
  - d) The insurer is immediately entitled to a higher premium

Answer

- 18- What is legal significance of a material misrepresentation in an insurance application?
- a) The contract is automatically voided from its inception
  - b) The contract is avoidable at the insurer's option
  - c) Loss payments are reduced by the degree of the misrepresentation
  - d) The insurer is immediately entitled to a higher premium

Answer

- 19- A false statement made by an applicant for insurance is an example of a
- a) Concealment
  - b) Breach of a warranty
  - c) Lack of offer and acceptance
  - d) Misrepresentation

Answer

20- Which of the following statements about insurance warranty is (are) true?

I -It is part of insurance contract

II - Statements made by an insurance applicant are considered warranties rather than representations.

- a) I only      b) II only      c) Both I and II      d) Neither I nor II

Answer

21- David, who lives in an apartment in a high – crime area, purchased an expensive car. In order to obtain physical damage insurance, David promised to park the car in an indoor garage with 24-security. This agreement, which was incorporated into the insurance contract ,is an example of a

- a) Representation  
b) Unilateral contract  
c) Contract of adhesion  
d) Warranty

Answer

22- Which of the following statements about an offer and acceptance for insurance contract is true?

- a) In property insurance the applicant accepts the offer by completing the application and paying the first premium  
b) In life insurance .the agent can usually accept an offer by immediately binding coverage  
c) In property insurance ,the offer and acceptance are usually in writing but may be oral  
d) In life insurance .the offer is merely the promise to pay the first premium

Answer

23- Assuming life insurance applicant who has been given an insurability premium receipt is found to be insurable, when is the coverage effective?

- a) On the date of application or the date of medical examination ,whichever is later  
b) On the date of application or the date of receipt, whichever is earlier  
c) On the date of application or the date of receipt, whichever is later

- d) On the date of receipt or the date of medical examination, whichever is earlier

Answer

24- Which of the following statements about consideration in an insurance contract is (are) true?

- I- The insured's consideration is the completion of the application  
II- The insured's consideration is the promise to do those specified in the policy.

- a) I only      b) II only      c) Both I and II      d) Neither I nor II

Answer

25- A contract in which the values exchanged are not equal because chance is involved is called a(n)

- a) Contract of adhesion  
b) Unilateral contract  
c) Conditional contract  
d) Aleatory contract

Answer

26- Why are insurance contract said to be contracts of adhesion?

- a) The values exchanged are not equal  
b) One party writes the contract and the other party must accept the contract as written.  
c) Only one party makes a legally enforceable promise  
d) Conditions are placed on the insurer's promise to perform

Answer

27- Why does the insured get the benefit of the doubt if an insurance policy contains any ambiguities or uncertainties?

- a) Because insurance contracts are aleatory  
b) Because insurance contracts are unilateral  
c) Because insurance contracts are conditional  
d) Because insurance contracts are contracts of adhesion

Answer

28- Why can an insurer refuse to pay a claim if an insured fails to abide by the policy provisions?

- a) Because insurance contracts are aleatory
- b) Because insurance contracts are unilateral
- c) Because insurance contracts are conditional
- d) Because insurance contracts are contracts of adhesion

Answer

29- Which of the following types of insurance policies can usually be assigned without the insurer's consent?

- I- Life insurance
- II- Property insurance
- III-

- a) I only
- b) II only
- c) Both I and II
- d) Neither I nor II

Answer

30- What is the practical effect of an insurance policy being a conditional contract

- a) The insurer can refuse to pay claims unless the insured has complied with all policy conditions.
- b) The insured can assign the policy only with the insurer's consent
- c) The insurer can sue The insured for failure to pay any premiums
- d) The insured gets the benefit of the doubt if a policy contains any ambiguities or uncertainties

Answer

31- What is the practical effect of an insurance policy being a contract of adhesion?

- a) The insurer can refuse to pay claims unless the insured has complied with all policy conditions.
- b) The insured can assign the policy only with the insurer's consent
- c) The insurer can sue The insured for failure to pay any premiums
- d) The policy is interpreted in the insured's favor if a policy contains any ambiguities or uncertainties

Answer

- 32- All of the following statements about the rules governing agency relationships are true Except
- a) An agent must be authorized to act on behalf of a principal.
  - b) An agency agreement may grant certain powers to the agent as well as denying the agent other powers.
  - c) The principal is responsible for the acts of agents only if the acts are fraudulent.
  - d) Knowledge of the agent is presumed to be knowledge of the principal with respect to matters within the scope of the agency relationship.

Answer

- 33- The voluntary relinquishment of a legal right is called
- a) Subrogation
  - b) Adhesion
  - c) Estoppel
  - d) Waiver

Answer

- 34- Samy purchased a living room set for \$1000 and insured this furniture on an actual cash value basis. Two years later the living room set was destroyed by a covered peril. At the time of loss, the property had depreciated in value by 25 percent. The replacement cost of the furniture at the time of loss was \$1200. Assuming no deductible, how much will Sammy receive from her insurer?
- a) \$900
  - b) \$950
  - c) \$1000
  - d) \$1200

Answer

- 35-Osama sold his house to Aaya for \$140,000 in cash. Osama “threw in “the insurance on the house as part of the deal and did not bother telling the insurer that there was a new owner. Four months after Aaya purchased the home , a windstorm damaged the roof. Which of the following legal characteristics of insurance contracts could the insurer use to legally deny payment for damage to the roof?
- a) Insurance contracts are unilateral contracts.
  - b) insurance contracts are contracts of adhesion

- c) insurance contracts are aleatory contracts
- d) insurance contracts are personal contracts

Answer

- 36- Sally's car was damaged when another driver ran a stop sign and hit her car. Sally decided to collect from her own insurer and to let her insurer recoup the loss payment from the driver who hit her. What fundamental legal principle upon which insurance is illustrated in this scenario?
- a) The principle of Utmost good faith
  - b) The principle of Insurable interest
  - c) The principle of Subrogation
  - d) The principle of reasonable expectations

Answer

- 37- When Ben applied for a life insurance policy, he was asked on the application if he smoked or used tobacco products. Ben answered "No". In reality, however, Ben smokes two packs of cigarettes a day. The policy was issued at the "preferred, nonsmoker premium rate". If Ben dies six months after the policy is issued, upon what grounds will the insurer be able to legally deny the claim?
- a) Warranty
  - b) Misrepresentation
  - c) Waiver
  - d) Concealment

Answer

- 38- Shaker's insurance claim was denied by XYZ Insurance company. When Shaker inquired why the claim was denied, he was told to "Read the exclusion on page 5 of the policy". Shaker read the exclusion. In his opinion, the exclusion was poorly worded and very vague. If a court of law agrees with Shaker's assessment of the exclusion, Shaker may still be able to have his claim paid by the insurer because insurance contracts are
- a) Personal contracts
  - b) Unilateral contracts
  - c) Aleatory contracts
  - d) Contracts of adhesion

Answer

39- Omar entered into an insurance contract with XYZ insurance Company. When the agent who sold the coverage witnessed Omar doing something that violated the terms of the contract, he threatened to sue him to make him comply with the terms of contract. Which distinct legal characteristic of insurance contracts states that only the insurer's promise to perform is legally enforceable?

- a) Contracts of adhesion
- b) Unilateral contracts
- c) Aleatory contracts
- d) personal contracts

Answer

40-which of the following does not constitute an insurable an interest ?

- a) A savings and loan company holding a mortgage on your home .
- b) You make an offer to buy your neighbor's house.
- c) Your lease makes you liable fo fire damage to your rented premises.
- d) You have custody of a valuable painting when the owner is away.

Answer

## **QUESTION Two**

### **TRUE FALSE QUESTIONS**

1-in the case of life insurance contracts, an insurable interest must exist at the inception of the policy

2- When there is a difference of opinion regarding the meaning of a term in an insurance policy, the courts usually favor the insured

3- In most fields of insurance, any misrepresentation by the insured, intentional or otherwise, will normally be sufficient to void the policy

4- The term "actual value "is generally interpreted to mean the actual dollar loss incurred by the insured, measured by his or her original cost of property destroyed.

5- Murder of the insured by a beneficiary usually relieves the insurer of the obligation to pay policy proceeds

6- the courts have generally ruled that the term "actual cash value" varies from situation to situation and therefore cannot be defined.

7- The doctrine of utmost good faith is applied more rigidly in the field of ocean marine insurance than in other fields of insurance.

8- In the field of life insurance, there is no requirement that an insurance policy be supported by an insurable interest.

9- it is possible for an individual who does not own a piece of property to have an insurable interest in that property.

10- The doctrine of insurable interest was developed to prevent the use of insurance contracts as means of wagering, and to protect against moral hazard.

### **QUESTION THREE (DEFINITIONS)**

#### ***DEFINE THE FOLLOWING:-***

- 1- Representations
- 2- Warranty
- 3- Exceptions of principle of indemnity
- 4- Principle of subrogation
- 5- Purposes of subrogation principle
- 5- Waiver, Binder and Estoppel
- 6- Explain by example, what is the meaning Pro rate share in Principle of contribution in insurance
- 6- Insurable interest
- 7- Purposes of Insurable interest
- 8- The extent of insurable interest

## **QUESTION FOUR**

### ***Fill in***

- 1- The concept of utmost good faith principle is implemented by three legal doctrines, they are-----,-----, and-----
- 2- the period of principle of utmost good faith is in force at -----of insurance with agent or insurer up to the policy is issued
- 3- Representation is-----, but Misrepresentation is-----
- 4- Concealment means-----
- 5- Insurable interest means-----
- 6- Insurable interest exists only at ----- in life insurance ,but at ----- in property insurance
- 7- All insurance contracts are subject to principles of-----,-----,and----. But, personal insurance contracts (i.e. life insurance), are subject to principles of-----, ----- ,and -----
- 8- Principle of indemnity applies most insurance lies except -----
- 9- The purposes of Principle of indemnity are ----,----- and,-----
- 10- Providing indemnity in property insurance may be ----- or----- or -----
- 11- The main methods by which we can determine actual cash value are---- ,-- --- and -----
- 12- Importance of subrogation principle are --- ,----- ,---- and -----
- 13 - the purposes of an insurable interest are ----- ,-----, and -----
- 14- The formula for calculating contribution in insurance is -----
- 15- legal characteristics of insurance contracts are ---,---- ,--- ,--- and ----

## **QUESTION Five**

Read the following *Applied Cases , then answer*

### **The first Applied Case**

Mohamed owns a laptop computer that was stolen. The laptop cost \$1000 when it was purchased five years ago. A similar laptop computer today can be purchased for \$500. Assuming that laptop was 50percent depreciated at the time the theft occurred,what is actual value of the loss?

### **Solution**

### **The second Applied Case**

Osman owns an antique table that has a current market value of \$12000. The table is specially insured for \$12000 under a valued policy. The table is totally destroyed when a tornado touches down and damages Osman's home. At time of the loss, the table had an estimated market value of \$10,000. How much will Osman collect for the loss? Explain your answer

### **Solution**

### **The third Applied Case**

Osama is applying for a health insurance policy. He has a chronic liver ailment and other health problems. He honestly disclosed the true facts concerning his medical history to the insurance agent. However, the agent did not include all the facts in the application. Instead, the agent stated that he was going to cover the material facts in a separate letter to the insurance company's underwriting department. However, the agent did not furnish material facts to the insurer and the contract was issued as standard. A claim occurred shortly thereafter. After investigating the claim, the insurer denied payment. Osama contends that the company should pay the claim because he answered honestly all questions that the agent asked.

- a) On what basis can insurance company deny payment of the claim?
- b) What legal doctrines can Osama use to support his argument that the claim should be paid?

### **Solution**