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The Divisibility of Warranties in Insurance Policies

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NOTE

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I. Introduction

Few purchasers of insurance are in a position to bargain for a policy other than the one the insurer has already reduced to a printed form. Because such policies are merely adhesion contracts, courts have been willing to construe them in a manner most favorable to the insured.[1] The need for such a construction frequently occurs when an insurance company alleges that an insured's conduct has violated the terms of his policy, thereby, releasing the company from any obligation to pay the insured's claim. The most familiar technique used by the courts is to choose the interpretation of policy language most favorable to the insured where several interpretations are possible. Thus, interpretation of an ambiguous warranty in favor of the insured may well result in a holding that the warranty was not breached. Take for example the language of Chief Justice Shaw of Massachusetts:

> By a *substantial* compliance, we mean the adoption of precautions, if not exactly those stated in the application, precautions intended to accomplish the same purpose, and which may be reasonably considered equally or more efficacious. For instance, when it is stated that ashes are taken up in iron hods, it would be a substantial compliance, if brass or copper were substituted. So, when it is represented that casks of water, with buckets, are kept in each story, if a reservoir were placed above, with pipes to convey water to each story, and found by skillful experienced persons to be equally efficacious, it would be a substantial compliance.[2]

The doctrine of substantial compliance, and other rules of construction such as the rule calling for an interpretation of warranties as being promissory rather than continuing, are familiar and frequently applied. When applied in favor of the insured, the usual result is to find that the insured has not breached the warranty. This note deals with a less frequently employed tool of beneficent interpretation and one whose thrust is different, the divisibility of warranties. The doctrine of divisibility does not result in a finding of "no breach";

1. Aschenbrenner v. United States Fid. & Guar. Co., 292 U.S. 80 (1934); Stipcich v. Metropolitan Life Ins. Co., 277 U.S. 311 (1928); Thompson v. Phenix Ins. Co., 136 U.S. 287 (1890).

2. Houghton v. Manufacturer's Mut. Fire Ins., 49 Mass. 114, 122 (1844).

instead it admits the breach, but deems it immaterial because it is not related to the risk of that type of loss which has taken place.[3]

This note begins with a brief review of the nature of warranties in insurance policies, and a discussion of beneficent interpretations other than divisibility, so that the reader can understand the operation of the divisibility doctrine in its true context. The bulk of the note then sets out those cases in which the doctrine is properly employed, in an attempt to demonstrate and articulate an underlying theme which is both unified and coherent.

II. BENEFICENT APPLICATION OF WARRANTIES

A. *Nature of a Warranty*

Warranties are included in insurance policies to limit the risks assumed by the insurance company. As statements concerning the status of the subject of the policy, they create conditions of the insurer's duty to indemnity,[4] even when they are not expressly made conditional. By delineating the scope of a risk through the use of warranties, an insurer has conditioned his coverage on the assumption that the statements in the warranties are correct. Therefore, it is unnecessary for each warranty to state that its fulfillment is a condition of coverage. Because strict interpretation of warranties resulted in many injustices, a number of techniques have been developed to ameliorate their effect. One of these, the doctrine of substantial compliance, was mentioned in the introduction. Others are outlined in the next few paragraphs.

Before discussing these approaches, however, it should be pointed out that construction of contract language in favor of the insured does not necessarily mean abandonment of strict interpretation. At times, strict construction will lead to results very favorable to an insured, and when this is true, the principle of freedom of contract comes reasonably into play, for an insurer should be regarded as sufficiently knowledgeable to realize what it is putting in its contracts. An illustration of the benefits that may come to an insured by means of strict construction occurred in a non-warranty case,[5] where a policy was enforced against the insurance company even though the insured would receive payment without having suffered any loss. The insured had leased and improved the premises. A fire policy endorsement covering the improvements provided that despite any lease or contact by the insured, the insurer would treat the

3. McCormick v. Potomac Ins. Co., 255 N.Y. 302, 174 N.E. 689 (1931).
4. PATTERSON, INSURANCE 275 (1957).
5. Foxbilt, Inc. v. Citizens Insurance Co., 128 F. Supp. 594 (S.D. Iowa 1955).

insured as the sole and unconditional owner in event of damage by fire. The improvements were subsequently damaged by fire, and they were repaired by the landlord at no expense to the insured. These repairs were held not to lessen or remove the insurer's liability under the endorsement. The freedom to contract allowed in this case seemingly ignores a concept of public policy under which some states limit the insured's recovery to indemnification only. The courts have justified recovery in excess of indemnification by relying on the above principles of freedom to contract and strict construction in favor of an insured in construing insurance contracts.[6]

B. *Substantial Compliance*

The theories of substantial performance and divisibility of warranties are closely allied. As an example, consider a warranty that a building is to be guarded by a watchman. During a temporary absence of the watchman the building catches fire and burns. Courts have held that it was not within the contemplation of the parties at the time the warranty was agreed to that the watchman would never be away. The protection sought by the insurer was that of a watchman being about the premises after normal working hours in order to lessen the danger of a fire breaking out and remaining undiscovered. It was known by the parties that temporary absence for personal convenience would take place. "A mere temporary absence . . . would not affect the risk," according to the court in *Hanover Fire Insurance Co. v. Gustin.*[7] If the risk was not affected, there has been substantial compliance, but it is worth noting that the court also resorts to the same fiction of giving weight to the intention of the parties in the substantial performance situation as it will in the case of a divided warranty. This fiction opens the way for a different type of substantial performance from that enunciated by Shaw, "reasonably considered equally or more efficacious"[8] to what was warranted. Thus, substantial performance has been found to be that which the insured could reasonably be expected to do in compliance with a continuing warranty, or that which increases the risk only a slight degree more than it was warranted to be, or that which causes only a temporary breach of a continuing warranty insufficient to avoid the contract.

Substantial performance does not admit a breach of warranty as does the dividing of a warranty. When the court decides that there

6. Batchlor v. American Health Ins. Co., 234 S.C. 103, 107 S.E. 2d 36 (1959); Kopp v. Home Mut. Ins. Co., 6 Wis. 2d 53, 94 N.W.2d 224 (1959).

7. 40 Neb. 828, 59 N.W. 375 (1894).

8. See note 2 *supra.*

has been substantial compliance with a warranty there is no need to consider dividing it. Yet, it is not always easy to tell under what theory a court is proceeding, and in some cases both theories might be or have been used. Consider a hypothetical case in which an insured is protected both against fire loss to his buildings and against loss by theft to its contents under a single policy requiring a watchman to be on duty. This watchman is performing the function of protecting against two types of risks. His presence is designed to detect a fire that has begun and also to prevent breaking and entering by a thief. Closer and more continuous observation of the building by the watchman is required to prevent theft than to protect against fire.[9] If the watchman is absent from the building for a short period of time and the building catches on fire, the nature of the absence may be such that the warranty has been complied with substantially. However, the same short absence by the watchman might breach the warranty as to the theft coverage. This breach would require a division of the warranty that a watchman will be present, and if the loss is by fire a court will often find that the problem is solved by substantial performance.[10]

Sometimes a warranty that a watchman will be on duty is breached by the action of the employee hired as a watchman by his leaving the place of duty contrary to the instructions of his employer. If the employer-insured uses due care in hiring and instructs this watchman that compliance with the employer's instructions will also comply with the insurance policy warranty, the subsequent breach will be considered to be solely due to the neglect of the watchman. In this situation a court will usually divide the warranty and not impute negligence or fraud to the insured by means of the master-servant relationship, because the employer has in good faith attempted to perform the duties required by the terms of the policy. Fault or negligence of the employee, not the employer, was the cause of the loss. The risk that an employee may not behave as he has been instructed is normally a risk covered by the insurance company.[11] The insured has done the best that he can reasonably be expected to do, which places the case under a facet of substantial compliance, but it was first necessary to divide the warranty to determine what risk was involved.

9. See Goldberg v. Central Sur. & Ins. Corp., 145 Kan. 412, 65 P.2d 302 (1937); Goldstein v. Royal Indem. Co., 297 Mass. 55, 7 N.E.2d 420 (1937).

10. McGannon v. Michigan Miller's Mut. Fire Ins. Co., 127 Mich. 636, 87 N.W. 61 (1901). See also Sierra M.S. & M. Co. v. Hartford Fire Ins. Co., 76 Cal. 235, 18 Pac. 267 (1888).

11. King Buck Mfg. Co. v. Royal Ins. Co., 164 Mass. 291, 41 N.E. 277 (1895); Cowan v. Phoenix Ins. Co., 78 Cal. 181, 20 Pac. 408 (1889); Trojan Mining Co. v. Fireman's Ins. Co., 67 Cal. 27, 7 Pac. 4 (1885); Wenzel v. Commercial Ins. Co., 67 Cal. 438, 7 Pac. 817 (1885).

C. *Interpretation as Affirmative Rather Than Continuing Warranty*

A promissory or affirmative warranty is one which makes a statement in the present or past tense; a continuing warranty is a promise of the existence of the fact warranted from the date of the statement for the duration of the policy, including a reinsurance. Since statements as to future conditions are inherently subject to greater error, it is more favorable to the insured to construe warranties as affirmative; such is the normal tendency of the courts. When a court decides that a warranty is severable or divisible it has determined that there is more than one risk involved and these may be individuated.[12] A consideration of whether a warranty is promissory or continuing, on the other hand, is not addressed to the materiality of a warranty or condition. It is a later consideration. It must be decided that a warranty is material before it is appropriate to determine the time at which the warranty is made.[13] Thus, there is much the same relation between divisibility and the principle favoring construction of warranties as affirmative as between divisibility and substantial compliance.

D. *"Increase of Hazard" v. "Contribute to the Loss"*

Let us suppose for a moment that a warranty has been breached at the time a loss occurs under the policy. Three possible relationships exist between that breach and the loss itself. First, it is possible that the breach has no bearing whatever on either the loss or the risk of loss; in this event, the breach would generally be regarded as immaterial. Second, it is possible that the breach may increase the risk of loss, but may not have actually caused (either in whole or in part) the loss that actually took place. Third, the breach may have brought about the loss. The older common law did not inquire into the facts of a case beyond asking whether the breach existed; if so, it was a bar to recovery on the policy. This view is now outdated.[14] Today the controversy that exists is between the "increase-of-hazard" approach, under which recovery is barred if the breach increases the risk of loss whether or not it actually contributes to the particular loss, and the "contribute-to-the-loss" view under which only those breaches which in some way cause the loss bar recovery.

A number of states have now enacted statutes which require that

12. PATTERSON, *op. cit. supra* note 4, at 342-46; VANCE, INSURANCE 110 (1951).

13. Since a breach of an immaterial warranty will not prevent recovery. National Reserve Ins. Co. v. Ord, 123 F.2d 73 (9th Cir. 1941); Joseph Gordon, Inc. v. Mass. Bonding & Ins. Co., 299 N.Y. 424, 128 N.E. 204 (1920).

14. All states now inquire into materiality, many under statutes changing warranties into representations. See, *e.g.*, ILL. ANN. STAT. ch. 73, § 766 (Smith-Hurd 1940); MASS. ANN. LAWS ch. 175, § 186 (1959); MINN. STAT. § 60.85 (1946).

a breach of warranty contribute to the loss of the insured property.[15] This legislative action changes warranties from conditions limiting and delineating risks taken in to exceptions which restrict recovery on the basis of the cause of the insured event. The New York Standard Fire Insurance Policy form does not cover fires caused by extended war, internal political disturbances, acts of the government and neglect of the insured to take measures to save the property from impending fire. If the insured neglects to use all reasonable means to save and preserve the insured property at and after a loss or when the property is endangered by a nearby hostile fire, and this fire damages or destroys the insured premises, then the cause of the damages is neglect, which is an excepted cause, barring the insured's recovery.[16] An excepted cause must be the *sine qua non* of the loss, or such loss did not result from an excepted cause, and the insured will recover.[17] Therefore, a contribute-to-the-loss statute may change a warranty which is a condition precedent to recovery to an exception so narrow that recovery can not be denied by a breach of this warranty.

Some differences of opinion exist concerning the application of these statutes to moral hazard warranties. Some courts hold that a contribute-to-the-loss statute is inapplicable when there has been a breach of provisions of the policy which are material to the risk, but which by their very nature could not contribute to bring about the destruction of the property. An example of such a situation would be the wrongful concealment of the fact that other insurers had cancelled policies on certain property, when the insured was applying for a policy on that property.[18] This approach limits application of a contribute-to-the-loss clause to a breach of warranty which might have contributed to bring about the loss, but which did not.

The statutory language of legislation imposing a contribute-to-the-loss limitation is not uniform. Burden of proof in showing what caused

15. IOWA CODE § 515.101 (1949), "Any condition or stipulation in an application, policy, or contract of insurance, making the policy void before the loss occurs, shall not prevent recovery thereon by the insured, if it shall be shown by the plaintiff that the failure to observe such provision or the violation thereof did not contribute to the loss." See MICH. STAT. ANN. § 5327(a) (1948); NEB. REV. STAT. § 44-358 (Supp. 1952); TEX. INS. CODE ANN. art. 6.14 (1952), "No breach or violation by the insured of any warranty, condition or provision of any fire insurance policy, contract of insurance or application thereof, upon personal property, shall render void the policy or contract, or constitute a defense to a suit for loss thereon, unless such breach or violation contributed to bring about the destruction of the property."

16. Jablonski v. Gerard Fire & Marine Ins. Co., 113 N.J.L. 465, 174 Atl. 689 (N.J. Ct. App. 1934).

17. Calmar Steamship Corp. v. Scott, 345 U.S. 427 (1953).

18. Fireman's Fund Ins. Co. v. Wilburn Boat Co., 201 F.2d 833 (5th Cir. 1953), *rev'd*, 348 U.S. 310 (1955), *remanded for trial*, 259 F.2d 662 (5th Cir. 1958), *cert. denied*, 359 U.S. 925 (1959), *remanded for trial*, 199 F. Supp. 784 (E.D. Tex. 1960), *rehearing denied*, 371 U.S. 854 (1962).

a loss is often crucial. A fire loss usually destroys the reliable evidence of its cause and leaves only clues for conjecture,[19] making it difficult for either party to prove that a given breach did or did not contribute to the loss. The Iowa type statute, although it places the burden of proof on the insured to show that the breach of condition did not contribute to the loss,[20] is designed to allow recovery in many normal change of use situations. A typical situation where recovery is allowed occurs when the ground floor of a dwelling house is converted into a cleaning and dyeing shop that contains highly flammable liquids. The dwelling is destroyed by fire originating in a neighboring building. The fire enters the insured dwelling through the roof and consumes most of the building before the fire reached the flammable liquid on the ground floor.

Applying a statute under which the burden was on the insurer to show that the breach caused the loss, a Texas court in *Texas State Mutual Fire Insurance Co. v. Richbourg*[21] held that failure to install the required fire extinguishers was not a breach that contributed to the loss by fire because the person reporting the fire testified that the building was almost destroyed when he first discovered the fire. This is at least an arguably reasonable decision, but the *Liverpool Insurance Co. v. Nebraska Warehouse, Inc.*[22] situation is not reasonable. In this decision there was a warranty that the sprinkler system was operative and had an adequate water supply. In fact the system had been broken for thirteen days prior to the fire, and expert testimony stated that an operative sprinkler would have prevented much of the damage that occurred. Even so, the plaintiff recovered in full.

This probative burden on the insurance company is increased when contribute-to-the-loss statutes are applied to moral hazard warranties. An insurance company defendant must show that the insured was motivated by the breach of warranty to cause the loss and that he did cause it deliberately. Regardless of the warranty, the court would not allow recovery for deliberate destruction of property, so when a contribute-to-the-loss statute is applied to moral-hazard warranties, it eliminates them.[23] Yet, many persons who doubt the wisdom of

19. PATTERSON, *op. cit. supra* note 4, at 358.
20. IOWA CODE ANN. § 515-101 (1949).
21. 243 S.W. 590 (Tex. Civ. App. 1922).
22. 96 F.2d 30 (8th Cir. 1938).
23. Some cases do not elimiuate the warranty, but rather purport to recognize its proper relation to contribute-to-the-loss statutes. In Becker v. Kansas Cas. & Sur. Co., 105 Kan. 99, 181 Pac. 549 (1919), the insurer was not liable because misrepresentations as to prior claims and other insurance was material, although they could never contribute to the contingency insured against. In McPherson v. Comden Fire Ins. Co., 22 S.W. 211 (Tex. App. 1920), the warranty was breached as to encumbrances and record keeping, but statute was held not applicable. The decision was followed in Fireman's Fund Ins. Co. v. Wilburn Boat Co., *supra* note 18.

across the board application of contribute-to-the-loss statutes admit that they are reasonable for use by some states in the field of moral-hazard warranties. Moral hazard warranties have been deleted from many standard fire insurance contracts and others as a means of limiting or selecting risks. The court decisions of Texas, New Hampshire, and Nebraska in construing their statutes have had the same effect.[24] This conclusion was reached because moral-hazard warranties injure innocent insureds so often that their beneficial effect of preventing an occasional dishonest insured from recovering is outweighed.

This note is directed toward risks of a nature usually contemplated by both parties when the insurance policy was issued, but which were not necessarily articulated clearly as several different risks. A division of a warranty is made when two risks, *A* and *B*, are lumped together under a single warranty with no policy configuration or policy language to indicate the effect of a breach of the warranty as to one of these risks on the other risk. If there is a breach of warranty affecting risk *B*, which does not increase risk *A*, then a court is clearly justified in dividing the warranty. Whenever there is a breach of some warranty an insurer will be able to avoid payment on the policy more easily under an increase-of-hazard statute than under a contribute-to-the-loss statute, because a breach may well increase the risk of loss without actually causing the loss. The breach of warranties which actually contribute to the loss are not within the scope of this note, other than to show why they are excluded. *Fireman's Fund Insurance Co. v. Wilburn Boat Co.*[25] is an excellent vehicle for explaining these types of warranties. Article 6.14 of the Texas Insurance Code is a fairly typical contribute-to-the-loss statute which was possibly applicable in the instant case. The insured breached warranties against using the insured vessel to carry passengers for hire, mortgaging the vessel, or selling it without consent of the insurer, but these breaches did not contribute to the loss of the vessel by fire while at its mooring place. However, a policy clause said that the entire policy would be void if the insured had concealed or misrepresented any material fact or circumstance concerning the insurance or the vessel insured. The insured failed to disclose both the true nature of the boat's use and the fact that insurance had been refused on it by other companies. The court recognized two

However, other courts apply contribute-to-the-loss statutes to any condition operating before a loss has occurred and thereby remove moral hazard warranties from the policy. Strahorn v. Kansas City Fire & Marine Ins. Co., 241 Iowa 997, 42 N.W.2d 903 (1950) (transfer of a part of the insured interest); Slafter v. New Brunswick Fire Ins. Co., 242 Neb. 209, 5 N.W. 612 (1932) (encumberance); Johnson v. Farmers Ins. Co., 126 Iowa 564, 102 N.W. 502 (1905) (iron safe clause).

24. See note 3 *supra* and accompanying text.

25. *Supra* note 18.

distinct issues: (1) whether the facts concealed were material to the risk; and (2) whether any Texas statute would prevent the court from giving effect to the policy clause. The concealed facts were shown to be material because a larger premium would have been charged for the policy if the true facts had been given to the insurer. Since several other insurers had refused to write the policy when they knew the true facts, it is reasonable to assume that except for the misrepresentation of such facts the policy probably would not have been issued.

The court reasoned that misrepresentation or concealment of facts could never contribute to the loss of property, although the facts misrepresented or concealed could bring about the property's destruction. The clause voiding the policy for concealment or misrepresentation was aimed at assuring the insurance company that it would have sufficient facts on which to base its premiums. This clause was covered by article 21.16 of the Texas Insurance Code, which says that a provision in the insurance contract making the policy void because of misrepresentations is of no effect unless it is shown that the matter or thing misrepresented was material to the risk or actually contributed to the loss. Article 21.16 is broader than article 6.14 because it goes beyond those things which actually contribute to the loss and takes in misrepresentations of material facts that increased the risk of loss. Article 6.14 is applicable to physical hazards only and limits insurance companies in laying down rules that pertain to factors causing fires and requires these factors to contribute actually to the loss. Misrepresentation is a moral hazard, not a physical hazard, and article 6.14 of the Texas Insurance Code does not apply to the policy provision against concealment or misrepresentation. If the policy clause in question were within the purview of article 6.14, then article 21.16 would have a phrase that is meaningless, and that is not proper construction of a statute, nor is the common law rule as to deceit changed because article 21.16 applies only to non-fraudulent misrepresentations.[26] If a false statement is made with the intent to deceive the insuror the courts generally hold that the policy is made void by the policy provision concerning misrepresentation even if the misrepresentation relates to a fact which did not contribute to the loss.

III. Application of the Divisibility Approach

A. *The Non-Warranty Situation*

Breach of warranty cases are not the only ones in which courts

26. St. Paul Fire & Marine Ins. Co. v. Garnier, 196 S.W. 980 (Tex. Civ. App. 1917).

have been compelled to divide policies into component parts to reach a just result. A court's decision not to divide a policy favored the insured in *Merrimack Mutual Fire Insurance Co. v. Lanasa*,[27] where a hostile fire preceeded by an explosion destroyed the insured building. The insurer was held liable for the entire loss, although loss by explosion was excluded in the policy. The court in *Dillard v. Continental Insurance Co.*,[28] made a similar decision, but the facts of the case make it less of a construction problem than was *Merrimack*. The policy excluded damage caused by perils peculiar to flying, but a fire caused by an electrical failure in flight was included under the clause which covered fire loss. The significance of these cases is that they, in effect, involve the possibility of dividing the policies according to the risks involved. In *Merrimack* the building's consumption by a hostile fire was complete, thereby cutting off any intelligent consideration of how extensively the building had been damaged by explosion before the fire. *Dillard* follows the *Merrimack* type of reasoning by making its observation on a general level, rather than observing whether in that particular case the electrical failure in flight actually did cause the fire. In a non-warranty situation there is positive coverage and the loss that it covers has taken place. The court is not likely to read a preclusion of loss by explosion clause as providing an intervening cause that cuts off the insurers' liability under the insurance contract.

B. *Divisibility According to Res or Multiple Res Policies*

The divisibility of insurance contracts is most readily comprehended where several items of property with separately stated values are insured in one policy. Here the policy is susceptible of division on its face, the inference being that the insurance was as to separate items.[29] States differ as to the rule which will govern whether a policy is divisible or entire. Three distinct rules can be delineated from the decisions. (1) If the premium is paid in gross even though the property insured is separately valued, the contract is entire. This view is typified by *Garner v. Hawkeye Insurance Co.*,[30] which held that where the premium was gross or entire the contract was not divisible even though items were separately stated as to value because there was only a single contract and single consideration. The separate valuation is assumed to be for the purpose of limiting the

27. 402 Va. 562, 118 S.E.2d 450 (1961).
28. 130 So.2d 489 (La. App. 1961).
29. See, *e.g.*, such venerable and often cited cases as Royal Ins. Co. v. Martin, 192 U.S. 149 (1904); Trakas v. Globe & R.F. Ins. Co., 141 S.C. 64, 139 S.E. 176 (1927); Spradley v. Georgia Home Ins. Co., 112 S.C. 151, 98 S.E. 285 (1919).
30. 69 Iowa 202, 28 N.W. 555 (1886).

insurer's liability to a sum not in excess of such an amount.[31] This is a poor rule because of its reliance on the formality of the method of premium payment, an accounting procedure, which is often not an indication of the intention of the parties. Nor does it relate to the risks involved in the contract for insurance. (2) More reasonable is the view which divides the policy when the property is separately valued even though the premium is in gross. Yet this rule, because of its mechanistic approach, fails to match the risk against which insurance was purchased with the condition imposed by the policy to lessen that risk. Consider, for instance, two buildings located in close proximity to one another, covered by the same policy, but separately valued. If one is warranted sprinklered, will not a breach of that warranty likely increase the risk of loss to both?[32] (3) The most realistic rule permits dividing an insurance policy covering separate risks when the warranty breached relates to one risk and not to the other.[33] The court will consider whether or not the risk was increased by the breach of condition as to any particular item insured. Each case should be decided by the courts without an attempt at grandscale generalization. They should consider the risks involved and the possible effects of each particular breach of condition. Thus, even when different types of property are covered by the contract such a personalty, buildings, different buildings, or buildings and

31. Phoenix Ins. Co. v. Public Parks Amusement Co., 63 Ark. 187, 37 S.W. 959 (1896); Thomas v. Commercial Union Assur. Co., 162 Mass. 29, 37 N.E. 672 (1894) (personalty separately valued, contract held entire); Burr v. German Ins. Co., 84 Wis. 76, 54 N.W. 22 (1893). The most slavish adherence to form is when the premium was paid. See, *e.g.*, Harman v. American Cas. Co., 155 F. Supp. 614 (S.D. Cal. 1957); Johnson v. Sun Fire Ins. Co., 3 Ga. App. 430, 60 S.E. 118 (1908); Landry Wholesale Merchantile Co. v. New Hampshire Fire Ins. Co., 114 La. 146, 38 So. 87 (1905); Thomas v. Commercial Union Assur. Co., 163 Mass. 29, 37 N.E. 672 (1894).

32. PATTERSON, INSURANCE 344 (1957).

33. The appropriateness of dividing a warranty in an insurance contract along these lines has long been recognized by many states. See Hanover Fire Ins. Co. v. Crawford, 121 Ala. 258, 25 So. 912 (1898); Goorberg v. Western Assur. Co., 150 Cal. 510, 89 Pac. 130 (1907); Hartford Fire Ins. Co. v. Hollis, 64 Fla. 89, 59 So. 785 (1912); People & Planter's Mut. Fire Ass'n v. Wyatt, 31 Ga. App. 684, 121 S.E. 708 (1924); Capps v. Nat'l Union Fire Ins. Co., 318 Ill. 350, 149 N.E. 247 (1925); Phoenix Ins. Co. v. Pickel, 119 Ind. 155, 21 N.E. 546 (1889); Continental Ins. Co. v. Ward, 50 Kan. 346, 31 Pac. 1079 (1893); Continental Ins. Co. v. Gardner, 23 Ky. L. Rep. 335, 62 S.W. 886 (Ky. Ct. App. 1901); Parker-Russell Mining & Mfg. Co. v. Queen Ins. Co., 245 S.W. 1119 (Mo. App. 1922); Johnson v. Rocky Mountain Fire Ins. Co., 70 Mont. 411, 226 Pac. 515 (1924); State Ins. Co. v. Schreck; 27 Neb. 527, 3 N.W. 340 (1889); Jammal v. Girard Fire & Marine Ins. Co., 210 App. Div. 145, 205 N.Y.S. 561 (1924); Coleman v. New Orleans Ins. Co., 49 Ohio St. 310, 31 N.E. 279 (1892); Niagra Fire Ins. Co. v. Wilkson, 150 Okla. 123, 300 Pac. 686 (1931); Oatman v. Bankers' & Marine Mut. Fire Relief Ass'n, 66 Ore. 388, 133 Pac. 1183, *rehearing denied*, 66 Ore. 396, 134 Pac. 1033 (1913); Light & Co. v. Ins. Co., 105 Tenn. 480, 58 S.W. 851 (1900); Merchants' & Mfrs.' Lloyd's Ins. Exch. v. Southern Trading Co., 229 S.W. 312 (Tex. App. 1921); Bond v. National Fire Ins. Co., 83 .W. Va. 105, 97 S.E. 692 (1919).

their contents, the modern trend is to hold that such contracts may be divided so as to protect a portion of the property, even if the contract is void as to another portion.[34] The Supreme Court of Michigan in *Benham v. Farmer's Mutual Fire Insurance Co.*[35] gave a clear statement of this trend. It said that a policy for a single premium that specified certain amounts of coverage on a farm's dwelling, its barns, sheds, the furniture in the dwelling, products, equipment and livestock on the premises and in certain other locations was divisible. The insurance on the personalty was not lost by a breach of the warranty concerning the condition of the chimneys and of the warranty prohibiting any incumberance of the realty without authority except so far as the personalty was contained within the building as to which the risk was increased. Not only were separate items involved, but also the items were of different classes, so that the avoidance of the policy as to realty would not avoid the policy as to personalty.[36]

A court may be willing to divide a warranty if its breach has no effect whatsoever on the other items insured, but the same court may refuse to divide, and hold that a policy is entire, where the breach of condition or warranty contributes to the loss of one item while it increases the hazard to which other items are subjected.[37] The Vermont court, addressing itself to the problem, recognized that there were conflicting opinions, but it was willing to divide a warranty unless "the contract is affected by some all pervading vice, such as fraud, or some unlawful act condemned by public policy or the common law."[38] This reasoning explains a state's unwillingness to divide warranties in all situations, although a policy will not usually be held void merely because one of its warranties has been breached. Normally a breach of warranty must be an unlawful act or be against public policy or be fraudulent in order for it to void the entire policy. The divisibility of warranties approach may be applied to non-physical risks as well as to risks pertaining to physical things. As indicated, the typical warranties made concerning physical things may be divided, and an inspection of how this is done may be used in analyzing how to divide warranties concerning risks which do not have physical existence.

C. *Moral Hazard Warranties*

1. *Ownership.*—The warranty that an insured has an insurable

34. 4 APPLEMAN, INSURANCE LAW & PRACTICE § 2371 (1941).
35. 165 Mich. 406, 131 N.W. 87 (1911).
36. Springfield Fire & Marine Ins. Co. v. Green, 36 S.W. 143 (Tex. Civ. App. 1896).
37. Goorberg v. Western Assur. Co., 150 Cal. 510, 89 Pac. 130 (1907).
38. McGowan v. People's Mut. Fire Ins. Co., 54 Vt. 211, 215 (1881).

interest is considered to be continually made during the life of the policy. Courts are not liberal in construing this warranty when the insured has no title or interest in the property insured. Failure to have an insurable interest in property that one insures may not affect the physical hazards to which it is exposed, but the moral hazard inherent in permitting this practice is typified by the person who insures a building that he owns, sells the building, and then sets fire to the building in order to collect the insurance money. Failure to have an insurable interest in the property insured is against public policy, which has been said to be sufficient to declare a policy void without any consideration of dividing the warranties. It is instructive to look into the possible reasons for this rule. Such a hazard can be either material to the risk of it might contribute to the loss, but regardless of which requirement is demanded by a court or legislature, persons who fail to meet this continuing warranty as to insurable interest get curt treatment from the courts. The 1918 standard fire policy had a clause that stated in part that "if any change, other than by death of the insured, takes place in the interest, title or possession of the subject of insurance" the policy is void. There was also a descriptive warranty of sole ownership that is not exactly analogous to insurable interest, but it is useful as a vehicle to discuss the development of the insurable interest warranty from the interest and possession warranty.

The "sole ownership" warranty and the "interest, title or possession" warranty were designed to reduce the moral hazard in insuring property, but a strict enforcement of the warranty which voided the policy was seen by the courts to be harsh and not within the intent of the parties.[39] Therefore the above mentioned warranties, which were so stringently enforced in cases where there was no ownership at all, were divided in cases where the ownership changed, and it was obvious that the insured retained a substantial insurable

39. Hawkeye-Security Ins. Co. v. Prebitero Sons, 209 F.2d 281 (7th Cir. 1954); Gawecki v. Dubuque Fire & Marine Ins. Co., 72 F. Supp. 430, *aff'd*, 167 F.2d 894 (9th Cir. 1948); Foundry Service, Inc. v. Beneflux Corp., 110 F. Supp. 857 (S.D.N.Y. 1953); Security State Fire Ins. Co. v. Harris, 220 Ark. 900, 251 S.W. 2d 115 (1947); Royal Ins. Co. v. Smith, 158 Fla. 472, 29 So. 2d 244 (1947); Foster-Porter Enterprises v. DeMare, 198 Md. 20, 81 A.2d 325 (1951); Strait v. Ray North, Inc., 343 Mich. 130, 72 N.W.2d 39 (1955); Sorter v. Citizens Fund Mut. Fire Ins. Co., 151 Neb. 686, 39 N.W.2d 276 (1949); Atlantic Cas. Ins. Co. v. Interstate Ins. Co., 28 N.J. Super. 81, 100 A.2d 192 (1953); Miller v. Phoenix Assur. Co., 52 N.M. 68, 191 P.2d 993 (1948); Burpo v. Resolute Fire Ins. Co., 90 Ohio App. 492, 107 N.E.2d 227 (1951); Adalex Lab., Inc. v. Krawitz, 270 P.2d 346 (Okla. 1954); Bright v. Pittsburgh Musical Society, 379 Pa. 335, 180 A.2d 810 (1954); Soyland v. Farmers Mut. Fire Ins. Co., 71 S.D. 522, 26 N.W.2d 696 (1947); Alamo Cas. Co. v. William Reeves & Co., 258 S.W.2d 211 (Tex. Civ. App. 1953); Cook v. Farmers Mut. Fire Ass'n., 81 S.E.2d 71 (W. Va. App. 1954).

interest. In *Clinton v. Norfolk Mutual Fire Insurance Co.,*[40] the conveyance by the insured of all his interest in property covered by a fire insurance policy, except an estate for life in a house thereon, did not void the policy on his interest, although a clause in the policy made the policy void in case of a change in the circumstances causing an increase in risk. There was no increase in the physical hazard, and the court held that more than a sale of part of the property in question was required to prove that the moral hazard had increased as to the property in which he retained an interest.[41] The courts' willingness to divide these warranties precipitated the change of the 1918 standard policy's warranty requirement of sole ownership and title which were concepts dependent on ownership of a physical object to the 1943 standard policy's warranty of insurable interest. Since the concepts of ownership of property in an amount less than a fee simple had been a part of the law for centuries, it is surprising that the concept of insurable interest, which was also not of recent vintage was not expressed in a warranty at an earlier time. The likely reason for the late arrival of insurable interest in the standard fire policy warranties was the unwillingness of insurance companies to abandon the old wording, which would be enforced by some courts who took a literal approach, even though existent insurable interest was the warranty being made in states where the courts were willing to divide warranties.

The problem of an insurable interest is still prevalent particularly in liability insurance because the interest is not in something that is possessed, but is an interest in whether or not the insured may be charged with liability for a particular occurrence. Damage to the property is one risk, and separate from it is the liability imposed on a person because of his relation to the property. The moral hazard in the lack of an insurable interest in property does not have application to liability insurance since, by definition, liability insurers only indemnify. The case of *United Services Automobile Association v. Howe*[42] involved a father who purchased an insurance policy on an automobile that he gave to his son. The party injured in an accident with the son sued the father as owner of the car, and the insurance company declined to defend, alleging that the father's insurable interest had terminated. The father's dealings with the car involved in the accident were enough to convince the court that the father had an insurable interest.

2. *Additional Insurance.*—A disinclination to give the policy tech-

40. 176 Mass. 486, 57 N.E. 998 (1900).

41. *Contra,* Watts v. Phoenix Ins. Co., 134 Ga. 717, 68 S.E. 479 (1910), which refused to follow the general trend.

42. 208 F. Supp. 683 (D.Minn. 1962).

nical interpretation when carried into warranty considerations protects the interests of the insured. The problem of particularizing which insurable interest has increased the risk of loss of what property has not been handled satisfactorily by the courts because they have insisted on creating a generally applicable rule, rather than attempting to match risk and interest in a fair and just manner. *Bethune v. New York Underwriters Insurance Co.*[43] and *Graham v. American Eagle Insurance Co.*[44] serve as starting points for examining this area. The former case refused to divide a warranty that additional insurance would not be purchased on the insured premises because the warranty was a condition precedent to liability of the insurance company. However, the court allowed recovery on personal property within the building because the mortgagor's insurance did not include personalty, therefore the policy warranty was only breached as to the dwelling. The *Bethune* court was willing to make a severance of the policy along physical lines, even though it was considering a moral hazard warranty, and it did not seem to care that the exposure to a moral risk was increased as to the personalty, when the risk to the building containing the goods was so exposed. In *Graham*, the Fourth Circuit Court of Appeals refused to divide the same sort of warranty when a husband, co-tenant with his wife, breached the limitation of insurance warranty. The court said that the warranty would be breached for both tenants even though the additional insurance covered only the purchaser's interest in the property. The husband was clearly transacting business for both his wife and himself in the instant case, so his action could be imputed to her, since it could be assumed that any profit to be made from firing the insured building would be shared between them.

Moral hazard must be evaluated at two levels. At the general or overview level the increase in moral hazard caused by one co-tenant's over insurance will increase the hazard to the entire building, thus justifying the court's refusal to divide the warranty according to the insurable interest protected. This is reinforced in the case of related co-tenants. When the problem is particularized it becomes a dual question. First, does an increase in the moral hazard by one co-tenant actually increase the moral hazard overall? Second, if the co-tenant's interests are divergent and they are not related by ties more binding than common ownership of land, is it unfair to impute the breach of one insured to his co-tenant? Courts seem to be unanimous in holding that the breach of warranty by one co-tenant breaches the warranty as to both. This may appear harsh and unrealistic when applied

43. 98 F. Supp. 366 (E.D.S.C. 1951).
44. 182 F.2d 500 (4th Cir. 1950).

automatically, but it has a justification. The courts only recognize one insurable interest between the co-tenants for the purpose of judging whether or not the limitation of insurance warranty has been breached. When the insurance company accepts a single policy from co-tenants, it charges a rate commensurate with the risks involved, which includes the moral hazard that one co-tenant will over insure, and that hazard is circumscribed by a warranty limiting insurance coverage. The premium savings accruing to co-tenants by contracting as one insurable interest are earned at the risk of having actions by one co-tenant void coverage on the entire tenancy. Therefore, if the co-tenants wish to be treated as two interests for the purpose of insurance, each of the two insurable interests should be covered by a separate policy. The courts were responsible for the evolvement of the "sole interest" warranty into the insurable interest requirement, but they have been mindful of the risks involved and the cost of insuring them.

D. *Books and Records*

The requirement that inventory records and accounts of sales and purchases be kept in an iron safe and that failure to produce the books after loss will void the policy is to facilitate ascertainment of the amount of loss on the merchandise. A breach of this condition does not render the policy void but prevents recovery for loss on stock in trade or merchandise. A loss on business fixtures and furniture may be recovered, even though the insured would be defeated on the matter of recovery for the stock of goods.[45] Courts seem willing to divide this particular warranty and refuse to void a policy in toto unless the risk of not being able to determine the total inventory is increased. When the coverage is fire insurance, it has been held to be enough compliance to avoid a breach of warranty if the safe was closed, even though the combination dial was left so that the burglars could easily rifle the safe, and during the ensuing felony a fire broke out and destroyed the records.[46] The warranty requiring a fireproof safe was not breached because the safe was not burglar proof,[47] nor

45. This is another division of warranty according to res, which has long been recognized by the courts. See, *e.g.*, Mitchell v. Mississippi Home Ins. Co., 72 Miss. 53, 18 So. 86 (1894); Miller v. Delaware Ins. Co., 14 Okla. 81, 75 Pac. 1121 (1904); Sciara v. Fidelity & Cas. Co., Inc., 50 Tenn. App. 608, 362 S.W.2d 935 (1961. Many courts do hold that a breach of iron safe and inventory warranty voids an entire policy. See, *e.g.*, Fields v. Queen Ins. Co., 31 Ga. App. 683, 121 S.E. 697 (1924); Jaffe v. Niagara Fire Ins. Co., 116 Md. 155, 81 Atl. 281 (1911).

46. Home Ins. Co. v. Shriner. 235 Ala. 165, 177 So. 890 (1937); German American Ins. Co. v. Brown, 75 Ark. 251, 87 S.W. 135 (1905); Siemers v. Meeme Mut. Home Protection Ins. Co., 143 Wis. 114, 126 N.W. 669 (1910).

47. Pennsylvania Fire Ins. Co. v. Malone, 217 Ala. 168, 115 So. 156 (1928); Stovall v. Sterling Fire Ins. Co., 163 La. 284, 111 So. 707 (1927).

was there a breach of the warranty that the safe would be securely locked, since this warranty was intended to protect the insurance company from fraudulent and erroneous claims and to aid in adjustments. If the safe is one normally sold on the market as a fireproof safe, the fact that it is not a challenge to burglars is of no consequence. The above warranty applies only to the safe-guarding of records against fire.[48] These decisions could also have been made on the basis of substantial performance rather than on divisibility of warranty.

The same reasoning has been used where negligence of an employee causing a warranty to be breached has been found to be a part of the risk insured against when the iron safe clause was invoked.[49] In this case a bookkeeper removed the account books and last inventory of the insured from a fireproof safe because he feared that they might be destroyed by the fire that had broken out in the building if they were left in the safe. As the bookkeeper ran from the building, supposedly carrying the accounts and inventory to safety, he dropped some of the records, and they were destroyed by fire. The court was faced with a warranty by the insured that he would produce the records as a condition precedent to recovering for the loss caused by the fire. This warranty was extracted by the insurance company to protect it against spurious claims for destroyed inventory, and it was not designed to prevent an employee of the insured from attempting to take the records to safety, even though this was done in a negligent manner. The court divided the warranty by finding that the negligence of the bookkeeper was part of the risk insured by the insurance company, so that failure to produce the required records based on the employee's negligence was not a bar to recovery.

At times a case is decided on the basis of substantial performance without any mention of warranties being divided, although the decision would be a better reasoned one with fewer unanswered questions if the divisibility of warranties had been considered. In *Fidelity & Deposit Co. v. Friedlander*,[50] a small jewelry store was insured against loss by robbery of its merchandise, and the policy contained a warranty that there would be a custodian and one other employee in the store. When the robbery loss occurred, one of the persons, who the

48. See, *e.g.*, Griffin v. Implement Dealers Mut. Fire Ins. Co., 64 N.D. 146, 250 N.W. 780 (1933); London Assur. Corp. v. Poole, 212 Ala. 109, 101 So. 831 (1924); see 114 A.L.R. 584 (1938), for comprehensive listing.

49. East Texas Fire Ins. Co. v. Harris, 7 Tex. Civ. App. 647, 25 S.W. 721 (1894); see also note 11 *supra.*

50. 101 F.2d 106 (6th Cir. 1939). See also Foley v. Sonoma County Farmers' Mut. Fire Ins. Co., 18 Cal. 2d 232, 115 P.2d 1 (1941), where a policy clause caused lapse of coverage after a dwelling had been unoccupied for ten days. Fire loss occurred after ten days of family's two week vacation. The court concerned itself with construing the term "unoccupied" and held that there was no breach of warranty without considering a possible division of the warranty according to the risk involved.

insured insisted was an employee, was a window washer from a janitorial service and regularly performed clean-up functions in the store under the direction of the store manager. The court held that the janitor/window washer was an employee, therefore, there were two employees present within the store in compliance with the warranty. This differs from finding that the compliance was just as good as having two full-time employees because the court is saying that there were two employees, and nothing more is needed to fulfill the warranty. No mention was made of the risks involved which the moral-hazard warranty was designed to limit. When many small items are involved, an insured could pretend to have been robbed of articles which he had disposed of or which he never owned. The presence of another employee besides the person in charge reduces the likelihood of a faked robbery. It also increases the chance of identifying robbers, and a regular employee might be more careful in admitting strangers to the store, when it was not open for business. The court neither considered these questions nor attempted to align the risks involved with the warranty made. Although the result may be satisfactory, the decision does not consider all of the problems involved.

E. *Occupancy*

The court's willingness to divide a warranty does not always work to the advantage of the insured. In *Aiple v. Boston Insurance Co.*[51] the insured warranted that the insured dwelling house was occupied, but it was not. A statute of the state required that the insurer examine each structure insured, and the policy holder alleged that by virtue of this statute the insurance company was charged with notice that the house was not occupied as a dwelling. The court held that the insurer was not on notice as to non-occupancy because the statute, which became a part of the policy, was designed to force insurance companies to fix properly a value on the structure. Thus, the statute was intended to limit the risk of over evaluation at the inception of the policy rather than to prevent any protest or allegation of fraud after a loss had occurred. The court decided that the risk of over-evaluation was not involved in the warranty of occupancy, and it was only in cases of over-evaluation that the state statute precluded the insurance company from contesting its liability by denying that it had actual knowledge about the dwelling.

IV. WHAT LIES AHEAD

Thus far, it is obvious that the idea of dividing contracts of insurance so as to avoid what would amount to forfeiture of coverage

51. 92 Minn. 337, 100 N.W. 9 (1904).

is well developed and useful. In some states, the principle has now been incorporated into statute. For instance, in New York, section 150 of the Insurance Law provides in part:

> If the insurance contract specifies two or more distinct kinds of loss, damage or injury which are within its coverage, no breach of warranty shall avoid such contract or defeat such recovery thereunder with respect to any kind or kinds of loss, damage or injury other than the kind or kinds to which such warranty relates and the risk of which is materially increased by the breach of such warranty.

Yet even in New York, problems remain in interpreting and applying the concept. Many of these arise because of the development of new "hybrid" policies that seem to partake of the characteristics of several more traditional contracts. Consider, for example, the case of *Wood Patchogue Corp. v. Franklin National Insurance Co.*,[52] in which the New York Court of Appeals was confronted with a jewelers block policy. It was conceded by the named insured that certain of the warranties had been breached at the time he suffered a fire loss. He urged, however, that if the fire portions of the policy were considered to be simply a "standard fire policy" incorporated into a contract which otherwise would be thought of as an inland marine policy, these breaches would not bar recovery. The court stated that the jeweler's block policy was a new type of coverage, not permissible prior to enabling legislation allowing marine insurers to give fire coverage in their policies.[53] Therefore, the court held that because the policy did not incorporate the provisions of the standard fire policy, the warranties of the jeweler's block policy concerning the risk of loss by fire should be construed strictly as are inland marine warranties, rather than as representations, as standard fire policy warranties are construed. Thus, the policy insured against an inseparable combination of risks which could not be examined individually for a determination of whether or not there had been a breach of warranty as to any particular risk.

In reaching this decision the court relied heavily on the new authorization granted by the legislature which allowed insurance companies to write both fire and marine insurance in order to find that a new type of insurance was being written. Since this type of insurance is sold to a special class of business man for use in their particular business, it might be the intent of the parties, as understood by the insured, to enter an inland marine-all risk policy without the familiar elements of the standard fire policy. This assumes a great deal of technical expertise on the part of the average jeweler, and

52. 5 N.Y.2d 479, 186 N.Y.S.2d 42 (1959).
53. See N.Y. Ins. Law § 46, subd. 20.

it would also be a retreat from the original equitable purpose of discovering the intent of the parties. Paradoxically, courts in jurisdictions without the New York statute have found the jeweler's block policy to be severable into inland marine and fire portions.[54]

In contrast to the decision in *Wood Patchoque*, one should consider *Century Federal Savings & Loan Association v. Mers.*[55] Here, a mortgagor tendered a "homeowners policy" to the mortgagee to satisfy his obligation to keep the mortgaged buildings insured. This policy was rejected by the mortgagee because a homeowner's policy covers a number of unrelated risks in addition to the risks ordinarily covered by the standard fire policy, and acceptance of the tendered policy would subject the mortgagee to risks, burdens, and uncertainties that were not contemplated in the mortgage contract. The court held that the mortgagee was required to aceept the homeowner's policy because it was the legislature's intent in enacting section 311 of the New York Insurance Law (multiple line companies law) that it be read together with section 168 (Standard Fire Policy), so that an alternate form of insurance policy would be provided for homeowners, which included all of the essential virtues of the "Standard Fire Policy." The courts held the policy to be severable because of the nature of the agreement, the intent of the legislature and the intent of the parties, which the court noted were more significant factors in determining whether or not to sever a policy than matching separate premiums against separate risks covered. Continuing, the court said, "By the very purpose and nature of the 'homeowners policy,' severability and assignability of the fire risk coverage feature are implicit."[56]

The "homeowners" policy is a combination of coverages cataloged in section 46 of the Insurance Law, which the court stated were able to be combined by virtue of section 311, which states capital requirements that companies must meet depending on how many of the coverages listed in section 46 they wish to offer. In order to assemble a package as comprehensive as the "homeowners policy," it is necessary to pick parts of several of the types of coverages listed in section 46, including a part of the marine insurance, which was the subject of concern in *Wood Patchogue*. In that case the intent of the legislature was determined to be the creation of a new

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54. Hartford Fire Ins. Co. v. Owens, 272 S.W. 611 (Tex. Civ. App. 1925) (combination policy treated as if the insured had separate policies). *Contra,* Motors Ins. Co. v. Stowers, 206 Okla. 692, 246 P.2d 341 (1952).

55. 35 Misc.2d 717, 231 N.Y.S.2d 66 (1962), *aff'd,* 18 App. Div. 2d 795, 236 N.Y.S.2d 939 (1963).

56. 35 Misc.2d 717, 722, 231 N.Y.S.2d 66, 71 (1962), *aff'd,* 18 App. Div. 2d 795, 236 N.Y.S.2d 939 (1963).

type of insurance by considering only section 46. No mention was made there of any legislative intent to assist flexible and realistic writing of insurance as in *Century*. It is unlikely that a jeweler who had a standard fire policy, plus several other policies would think that he was buying a new type of policy that had interconnecting risks and did not give him the same protection against technical and harsh interpretations of his insurance policy, when he purchased a jewelers block policy to take their place. Probably, the new policy was brought to his attention by an insurance salesman, who pointed out that a convenient all-in one policy would cost less than his present coverage.

Moreover, once it has been determined appropriate to divide a policy along the lines of risk, whether as a matter of statue or of common law, there is the problem of how to subdivide the risks covered. An extreme example is *Diesinger v. American & Foreign Insurance Co.*,[57] where a jewelers block policy, insuring against all risks, contained a warranty that when the insured jewelry store was open for business the maximum value of the display in any one show window would be 5,000 dollars. The store was robbed by two armed gunmen at mid-day, when the display window contained jewelry worth 7,891 dollars, and the remainder of the stock, which was also taken, was in showcases or in the store's vault. The insurance company argued that since an express warranty had been breached the insured should not recover, but the court held that the warranty related only to the risk of loss by window smashing and not to hold-up loss. One can hardly help wondering just how the court divined the nature of the insurer's intent. Surely there might be speculation contrary to that of the court that excessive display of jewelry in general attracts theft.

Thus the problem remains: How can one best determine which warranties relate to which risks? Moreover, it is a problem which seems immune to precise statutory solution, since preparation of statutes to determine the proper results for each type of case we have surveyed plus those which one can envision would be an overwhelmingly detailed task. If there is to be a satisfactory resolution of the problem, it seems most likely that it will be along the line suggested by Professor Patterson some years ago: The acceptance by insurers of the concept of divisibility, and the preparation by them

57. 138 F.2d 91 (3d Cir. 1943). See also Karp v. Fidelity-Phoenix Fire Ins. Co., 134 Pa. Super. 514, 4 A.2d 529 (1939); Smith v. Denn Township Ass'n, 323 Pa. 93, 186 Atl. 130 (1936) ("While occupied as a dwelling not relevant to insurance on contents of building.") This may be going too far. *Contra*, Fidelity-Phoenix Fire Ins. Co. v. Pilot Freight Carriers, Inc. 193 F.2d 812 (4th Cir. 1952); Oates v. Continental Ins. Co., 137 W. Va. 501, 72 S.E.2d 886 (1952), where severability was denied.

of contracts which reasonably reflect this acceptance.[58] That this is not an unlikely turn of events is suggested by what has happened in the standard automobile policy.

Automobile insurance encompasses several events against which the insured has purchased protection. These events are as much different risks that are separately covered as are different types of property in a fire policy. Bodily-injury liability, property-damage liability, collision, theft, and fire are only part of the possible coverages, but they are sufficient to show clearly that several different possible events are covered. If an insured breached a condition against encumbering his automobile, this is relevant only to the coverage of events causing damage to the insured car. Even if that coverage were voided, a court may hold that such a breach is irrelevant to the coverage for bodily-injury liability to a third person. The encumberance provision is related to a moral hazard and does not increase the probability that an insured will negligently injure third persons.[59] On the basis of this reasoning the Standard Provisions (1955) for automobile insurance expressly state that encumberance provisions are applicable only to the coverages dealing with harm to the insured's car.[60] In recent years there has been an increase in

58. PATTERSON, *op. cit. supra* note 4, at 346.

59. Pauli v. Saint Paul Mercury Indem. Co., 167 Misc. 417, 4 N.Y.S.2d 41, *aff'd*, 255 App. Div. 935 (1938), *leave to appeal denied*, 280 N.Y. 853 (1939). See also Ohio Farmers Ins. Co. v. Lantz, 246 F.2d 182 (7th Cir. 1957); Ocean Acc. & Guar. Corp. v. Bear, 220 Ala. 491, 125 So. 676 (1929); Sly v. American Indem. Co., 127 Cal. App. 212, 15 P.2d 522 (1932); Mid-State Ins. Co. v. Brandon, 340 Ill. App. 470, 92 N.E.2d 540 (1950); Commonwealth Cas. Co. v. Arrigo, 160 Md. 595, 154 Atl. 136 (1931); Hunt v. Century Indem. Co., 58 R.I. 336, 192 Atl. 799 (1937); Kuntz v. Spence, 48 S.W.2d 413 (Tex. Civ. App. 1931), *rev'd on other grounds*, 67 S.W.2d 254 (Tex. Civ. App. 1931); Truck Ins. Exch. v. Hanson, 42 Wash. 2d 256, 254 P.2d 494 (1953). There is a small but growing group of cases which hold that warranties of ownership, if breached, are material to the risk of property damage or loss by theft, but which question whether the risk of the liability insurer is increased if the person insured does not own the vehicle covered by the property insurance. Opposed to this position are quite a number of cases that refuse to divide warranties as to property and liability risks, particularly when a warranty against encumbrances is involved. See, *e.g.*, Western Cas. & Sur. Co. v. Herman, 318 F.2d 50 (8th Cir. 1963); Didlake v. Standard Ins. Co., 195 F.2d 247 (10th Cir. 1952); Associated Indem. Corp. v. McAlexander, 168 Tenn. 424, 79 S.W.2d 556 (1935), which held that it was material to the insurance company's acceptance of risks that it knowingly insured automobiles that were encumbered.

The modern trend of dividing warranties by property risks and liability risks is strongest in the cases where a father owns a car, takes out insurance and later gives the car to his minor child for use by the child. While the ownership relationship is changed, liability insurance to protect the father is needed in the same amount as before. There is a real and continuing financial interest on the part of the father in having himself covered by an adequate amount of liability insurance, whether the car is registered in his name or not. Thus, the selection of risk argument is not applicable here, unless the insurers were in some way defrauded about who would be the principal user.

60. PATTERSON, *op. cit. supra* note 4, at 345.

coverages that are designed to protect against losses that can not be recovered in a court action. One such coverage is payment of medical expenses for persons who have a disability to sue the insured at common law (relatives). Another coverage is to protect against damage and injury by an uninsured motorist who injures the policy holder, passengers in his vehicle, or his property. The latter coverage concerns a risk so completely beyond the insured's control that he should probably recover for damage done to his automobile, even though he had violated the warranty against encumberances.[61]

This is not to say that specifying in the policy the coverage to be affected by a particular breach of warranty would solve all problems. The issue of materiality would still have to be dealt with, and no doubt some companies might attempt on occasion to stretch the logical relation between a breach and a particular coverage beyond the limits of reason. But at least a recognition in the policy of the possibility of division would provide the courts with an issue much more clearly drawn than is often now the case. To state it briefly, the issue would change a two-fold one (Is it proper in this case to decide that a given warranty does not bear on all risks covered? If so, to what risks does it bear a logical relation?) to a single question (Is the breach involved in this case material to the risk to which the policy says it relates?).

The need for such a course of action is increasingly obvious. A recent advertisement in the *Wall Street Journal* by Fireman's Fund American Insurance Companies begins:

"Now *one* policy covers *all* these *risks*—Rates them individually for the lowest premium cost!" Their Portfolio Policy is advertised to protect against burglary, "And also covers buildings, stock, equip-

61. Many courts will sever automobile policy warranties of notice, although in order to do so it is often necessary to rely on other types of insurance cases. *E.g.*, Rhine v. New York Life Ins. Co., 248 App. Div. 120, 289 N.Y.S. 117 (1936); Donley v. Glenn Falls Ins. Co., 184 N.Y. 107, 76 N.E. 914 (1906). Such severances will often be geared to the type of damage involved in an accident. The customary requirements placed on an automobile owner as a policy holder are that he give notice of any accident and forward all papers involving a law suit to the insurance company. The great weight of authority holds that an insured cannot recover if the liability policy expressly makes notice to the insurer a condition precedent to liability and the insured fails to give such notice. See, *e.g.*, State Farm Mut. Auto. Ins. Co. v. Cassinelli, 67 Nev. 131, 216 P.2d 606 (1950).

Even where an express statement requiring notice is not in the policy there is a trend toward making such notice a condition precedent to the insurer's liability. See, *e.g.*, Heimlich v. Kees Appliance Co., 256 Wis. 356, 41 N.W.2d 359 (1950). The opposing view is that absent an express clause requiring notice, delay will not result in an automatic forfeiture; but it will postpone the day of recovery. See, *e.g.*, Leach v. Farmer's Auto. Interinsurance Exchange, 70 Idaho 156, 213 P.2d 920 (1950). This is a division of the notice warranty to an extent, but it is directed more to purely hardship amelioration than to an ascertainment of the risks covered by the particular warranty.

ment, business, interruption, liability, medical payments, employee dishonesty, robbery, theft, transportation, and other optional coverages as needed." The advertisement states that a policy holder can save money with this policy because it is written to fit an individual's business and his hazards are individually rated so that he does not, "pay for someone else's dangerous risks or poor management." Assuming that the advertised benefits of individuation of risks are made a part of the policy it is accurate to say that this was the intent of the parties, when the contract was made. This built-in divisibility reinforces the decision of the courts to consider the risks as divisible, and it is a forward looking step by an insurance company.[62] It has been generally agreed that a court's decision to divide an insurance contract is based on equitable principles, whereby the courts avoid harsh technical forfeitures of the insured's claim, and that the explanation that the court is merely carrying out the intention of the parties is a fiction. This can be said with some certainty since no purchaser of such a "simplified" policy would expect to be subjected to more technical defenses than would be the case had he purchased separate policies. One can also say with equal certainty that courts are unlikely to enforce clauses stating that a breach of any condition will avoid the entire policy.[63] Thus, divisibility of the application of warranties is present, whether desired or not. Is it unreasonable, therefore, to expect that insurers who devise these multiple risk policies will in time link warranties and coverages more and more specifically? Not at all; it is already being done, with the automobile policy the most familiar example. It is to the advantage of both insurer and insured to have these matters spelled out clearly. Such a course of action should decrease litigation, and reduce ill will.

This note ends, therefore, on much the same thought as that with which it began. It is the company which writes the policy, not the insured. If the policy conditions seem to a court unreasonable or ambiguous, it will interpret them to favor the insured—and so it should. One of these methods of beneficent interpretation has been, and will continue to be, dividing policies when not to do so would be to deprive an insured of recovery when he has breached a warranty not relevant to the loss he has suffered. The only question, then, is whether the insurers who issue multiple risk policies will see fit to accept the concept of divisibility and write it into these policies

62. PATTERSON, *op. cit. supra* note 4, at 346; VANCE, *op. cit. supra* note 12, at 110.

63. Another approach is seen in Pugh v. Commonwealth Mut. Fire Ins. Co., 195 F.2d 83 (3d Cir. 1952), where Pennsylvania divides warranties by separating them into warranties which must be literally satisfied and conditions which will not avoid the policy unless their breach are material.

explicitly. There is ample precendent in present underwriting for doing so. Doing so would clarify the positions of the parties, and aid the courts in defining the issues in litigation. It is difficult to understand what would be lost.

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