

ROUTE TO:

## Duty to Advise

### Why Insurance Companies Have a Duty to Advise First-Party Insureds About Policy Terms and Conditions at the Outset of a Claim

by Tim Ryles, Ph.D.

The insurance industry has produced a significant body of literature on claims and has established several “designations” designed to improve the knowledge and skills of claims personnel. These sources discuss rules for good-faith claims handling, strategies for good negotiations and communications, unfair claims practices, and the way to process particular types of claims — e.g., automobile, commercial property, business interruption and homeowners. The material leans heavily in favor of the property and casualty fields.

The generally unexamined subject in standard sources, however, is the extent to which an insurance company bears a responsibility to sit down at the outset of a claim and inform a first-party insured of her rights under the policy, what coverage provisions apply to the claim, and what must be done to gain maximum benefits. Indeed, my experience in reviewing hundreds of claims is that some companies tend to adhere to a “Don’t ask, don’t tell” policy, meaning that if the insured does not inquire about specific policy provisions, an adjuster remains silent about them. Further, when an insured affirmatively asks questions, the adjuster is too often unable to provide the correct answer. This approach is what I characterize as the “Gotcha!” claims-adjustment method.

“Gotcha!” is 180 degrees removed from proper claims administration

because failure to inform insureds of coverage matters is an egregious act of omission, for several reasons. This article offers commentary about why an insurer has an obligation to engage the insured at the beginning of a claim and assist her in securing all relevant benefits of the insurance contract. The basis for the “sit-down conference,” during which an adjuster educates the insured about the claim and policy rights at the initial stages of a claim, arises from (1) the distinguishing features of the insurance contract, (2) common-law principles and (3) regulatory standards.

#### The Insurance Contract as a Basis for the Duty to Inform Insureds

In *Zilisch v. State Farm*, 995 P.2d 276, 279, Arizona’s Supreme Court affirmed, “An insurance contract is not an ordinary commercial bargain.” Unlike many consumer-protection measures fashioned to dull the sharp edges of *caveat emptor* in consumer-business relations, insurance law’s philosophical foundation is relatively free of *caveat emptor*. *Caveat emptor* (“let the buyer beware”) rewards the qualities of cunning and guile in commercial relations. Rules governing insurance relationships, on the other hand, stem from a background of utmost good faith, a tradition of a kinder and gentler nature of openness and trust. As one widely used college insurance textbook opines:

First, the insurance contract is one of utmost good faith — that is, each party is entitled to rely in good faith upon the representations of the other, and each is under an obligation not to attempt to deceive or withhold material information from the other. The rule of *caveat emptor* does not generally apply. (Black & Skipper, 180)

Outside academic circles, a text adopted in many states for agent prelicensing courses opines:

The insurance contract has certain characteristics not found in the typical non-insurance contract: Utmost Good Faith. The insurance contract requires utmost good faith between the parties. (Davidson, pp. 2-15)

An authority on ethics for life insurers adds, “Let the buyer beware ... is an outmoded principle for any type of

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In *Rawlings v. Apodaca*, 726 P 2d 565 (Ariz. 1986) the Arizona Supreme Court also developed this notion, explaining that insurance policies consist of essentially two covenants: the formally expressed commitments of the parties in the written text of the insurance policy and the implied covenant of good faith and fair dealing. The latter, said the court, dictates "that each of the parties was bound to refrain from any action which would impair the benefits which the other had the right to expect from the contract." (At p. 155) The court's emphasis is on the *right to expect* from the policy, not upon the policyholder's knowledge of what to demand.

The stronger party's failure to explain all applicable coverages is among the actions that would impair an insured's benefits.

Regulatory standards specifically mandate disclosure. The National Association of Insurance Commissioners Model Unfair Property/Casualty Claims Settlement Practices Regulation Section 5 (a) stipulates, "No insurer shall fail to fully disclose to first party claimants all pertinent benefits, coverages or other provisions of an insurance policy or insurance contract under which a claim is presented."

Although this article has emphasized an affirmative duty to advise, Section 5(b) suggests that *inaction* adversely affecting an insured's rights under a policy is not a means of circumventing the regulation's dictates. Section 5(b) says, "No agent shall conceal from first party claimants benefits, coverages or other provisions of any insurance policy or insurance contract when such benefits, coverages or other provisions

are pertinent to a claim." ("Agent" includes claims adjusters.)

Section 6(d) states, "Every insurer, upon receiving notification of a claim, shall promptly provide necessary claim forms, instructions, and *reasonable assistance* so that first party claimants can comply with the policy conditions and the insurer's reasonable requirements." (Emphasis added.)

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***"Unlike other 'financial services' products, insurance consists of public-interest elements, utmost good-faith principles, a heritage distinct from caveat emptor, and specific statutory and regulatory requirements setting it apart from normal rules of commercial relations."***

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The regulatory language is quite broad in regard to what an insurer must do and refrain from doing to fulfill its side of the bargain. It does not place upon the insured the responsibility of having to first inquire about coverages, nor does it provide that the duty is waived if an insured is represented by either an attorney or a public adjuster, as some insurers have been known to argue. The duty to advise and inform the insured is a continuous, unqualified duty of the insurer.

#### SUMMARY

Unlike other "financial services" products, insurance consists of public-

interest elements, utmost good-faith principles, a heritage distinct from *caveat emptor*, and specific statutory and regulatory requirements setting it apart from normal rules of commercial relations. These qualities strongly support the view that insurers have an affirmative duty to continuously advise first-party insureds of their rights and obligations under an insurance contract. Lethargic inaction is no excuse for noncompliance with regulatory standards. **REIA**

#### Sources

Davidson, Cindy, et al., *Licensing Sourcebook: Life and Health* (Santa Monica: Merritt Publishing Company, 1989).

National Association of Insurance Commissioners, "Unfair Property/Casualty Claims Settlement Practices Model Regulation," in National Association of Insurance Commissioners, *Model Laws, Regulations, and Guidelines*, Vol. V, 902-1 through 902-10 (Kansas City: Mo., 2006).

Pictorial. *Ethical Practices* (Indianapolis: Pictorial Publications, 1994).

Black, Kenneth, Jr., and Skipper, Harold D. *Life and Health Insurance*, 12<sup>th</sup> Edition (Englewood Cliffs, N.J.: Prentice-Hall).

Widiss, Alan I. "Obligating Insurers to Inform Insureds About the Existence of Rights and Duties Regarding Coverage for Losses," *Connecticut Insurance Law Journal* 67, (Spring 1995).

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commerce today and never was legitimately applicable to the sale of life insurance." In contrast to *caveat emptor*, this author proposes that the principle of *cognosceat emptor*, Latin for "Let the buyer know," is the more appropriate modern standard. (Pictorial, 101.)

A reasonable inference from this "utmost good faith" standard, therefore, is that in the insurance context there is a heightened duty governing the parties' relationship. Insureds buy insurance for purposes other than the pursuit of commercial advantage; rather, what an insured seeks is peace of mind, "good hands" security from a surrogate "good neighbor" that is "on your side" when "occurrences" bring harm and loss. These benefits are purchased from an insurance company that develops contracts of adhesion, holds the money and has years of experience dealing with novice claimants who are ill-informed about the product they bought to protect against life's misfortunes. Yet despite a status as the weaker party, the insured possesses the details about the risk assumed by the stronger party (the insurer) — details that should be revealed if they are material. Utmost good faith — honesty, openness, mutual assistance — benefit both parties in the long run. An open discussion of policy benefits is consistent with this principle.

The insurance contract is also more than a private agreement between two parties. The U.S. Supreme Court determined almost a century ago in *German American Insurance Company v. Lewis*, "The business of insurance is one so clothed with a public interest, affecting the community at large, as to render it peculiarly subject to governmental regulation."

233 U.S. 389 (1914). Georgia's Supreme Court, quoting favorably from the Lewis decision in 1939, affirmed an identical view at the state level, in *Cooper Company of Gainesville v. State*, 187 GA 497, 500. More recently, the Supreme Court of Texas stated, "[W]e have long recognized that the insurance industry is peculiarly affected with the public interest." *Universe Life Ins. Co. et al. v. Ida Giles*, No. 94-0992 Supreme Court of Texas 07-09-1997.

State insurance codes statutorily incorporate the public-interest element

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of an insurance contract as well. For example, a Washington statute states:

The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. RCW 48.01.030 - WA Code.

Idaho's statute affirms the same provision, but modifies it:

The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. Upon the insurer, the insured, and their representatives, and all concerned in insurance

transactions, rests the duty of preserving the integrity of insurance. Idaho Code § 41-113.

Preserving the integrity of insurance as a public-policy objective is obstructed, not advanced, in an atmosphere of secrecy, deception and exploitation of the other party's inexperience or ignorance. To overcome this "Gotcha!" threat, from a public-policy perspective, the public-interest element implies that an altruistic motive lies behind the insurance mechanism. Consistent with this notion, some observers see a fiduciary relationship in the public-interest quality of the insurance mechanism, while others describe it as at least quasifiduciary. Either is supportive of an insured's "right to know" the benefits of the bargain.

There is common-law support for disclosure of policy benefits as well. In *Barry Ducola v. Pennsylvania National Mutual Insurance Company*, 554 A. 2d 906 (Penn. 1989), the court opined:

The duty of an insurance company to deal with the insured fairly and in good faith includes the duty of full and complete disclosure as to all of the benefits and every coverage that is provided by the applicable policy or policies, including any time limitations for making a claim. (p. 478)

Professor Alan Widiss, who served as an expert in *Weber v. State Farm Mutual Automobile Insurance Company*, 873 F. Supp. 201 (S.D. Iowa 1994), also contends that, *inter alia*, the insurer's duty to inform insureds about coverages arises from the covenant of good faith and fair dealing that is implied in all insurance policies. (Widiss).

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Two of Robert Hughes Associates' valued employees have recently celebrated significant anniversaries with the company.

Jeanne Camp, FCAS, MAAA, the company's chief actuary, is celebrating 20 years with RHA. Jeanne joined RHA in August 1988 as a consulting actuary. She has been instrumental in the development and direction of our actuarial practice. She began her career in 1976 with United Services Automobile Association and was later a vice president at Actuarial Services of Texas and at Tillinghast, Nelson & Warren in Dallas.

Her background includes loss reserving, rate structure evaluation, financial modeling, and designing and implementing actuarial information systems. She has

experience working with traditional insurers as well as with self-insureds and captives.

Jeanne Greene, an administrative professional at RHA, is celebrating 15 years with the company. Jeanne is usually the first person whom RHA's visitors or callers see or hear. She is responsible for reception as well as accounts payable and other accounting duties. She also assists with report preparation and provides administrative support to the senior vice president and other professional consultants. Jeanne, a native of Maywood, New Jersey, joined RHA in 1993.

RHA is extremely grateful to both Jeanne Camp and Jeanne Greene for their many years of service! 

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