CHAPTER 12

Protection of Property—Bailment and Insurance

ASK A LAWYER

Cabinet Manufacturing Ltd. required additional storage space for its finished goods inventory and has decided to contract with a nearby warehouse to store its goods pending sale and shipment to customers. Management is concerned about the risks of storing its goods at the warehouse and how it might protect itself from loss.

At the direction of the company, the plant manager attended at the office of the company's lawyers for advice.

What advice would the lawyers provide to the manager?

LEARNING GOALS

1. **To outline the nature of bailment.**
2. **To examine the various forms of bailment.**
3. **To describe the various forms of insurance.**
4. **To examine the nature of insurance and concept of indemnity for loss.**
5. **To identify the parties associated with insurance contracts.**

12.1 NATURE OF BAILMENT

Bailment
The transfer of a chattel by the owner to another for some purpose, with the chattel to be later returned or dealt with in accordance with the owner's instructions.

Bailor
The owner of a chattel who delivers possession of the chattel to another in a bailment.

Bailee
The person who takes possession of a chattel in a bailment.

Bailment is a common type of business arrangement. In its simplest form, it is an arrangement between a person (a **bailor**) who owns or lawfully possesses goods and another person (a **bailee**) who is given possession of the goods for a specific purpose. Many business activities involve the transfer of possession of goods. For example, the storage of goods or equipment in a warehouse by a business is a bailment transaction because the ownership of the goods remains with the business and the warehouse operator holds the goods for the owner but does not have title to the goods. Similarly, where goods are shipped by a common carrier, such as a highway truck transport company, the carrier of the goods has possession of them only as a bailee. The carrier is responsible for the goods until they are delivered to the person or business named as the receiver. Other examples of business transactions that include a bailment would be transactions that require goods to be left with repair services, such as motor vehicle repair garages, jewellery shops, and appliance repair facilities.

A bailment consists of three parts:

1. The delivery of the goods by the bailor to the bailee
2. Possession of the goods by the bailee for a specific purpose
3. A return of the goods to the bailor at a later time, or the delivery of the goods according to the bailor's directions

Sub-bailment

Sub-bailment
A person who agrees to hold goods delivered by a bailee for a specific purpose.

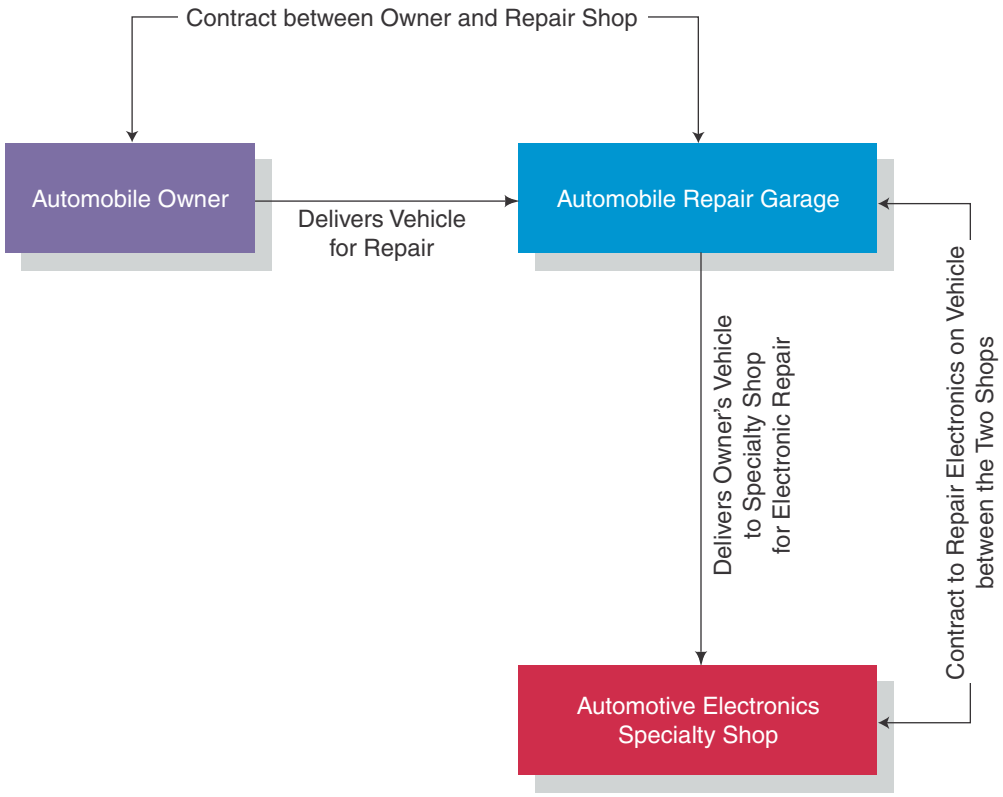
In some cases, a second or **sub-bailment** may take place. A sub-bailment is made when a person or business that holds goods as a bailee gives the goods to another person or business to hold the goods as a bailee. In a sub-bailment, the bailee becomes the sub-bailor, and the person who takes delivery of the goods from the sub-bailor becomes the sub-bailee. Sub-bailment, however, must normally only be by special agreement between the original bailor and bailee or be a custom or practice of the trade relating to the particular type of bailment. The right to make a sub-bailment is not a part of every trade activity, but the courts have held that bailments involving automobile repairs, the carriage of goods, or the storage of goods are trade activities in which a sub-bailment may customarily be made by the bailee. However, a sub-bailment normally may only be made where the bailor is not relying on the special skill of the bailee to perform the work or service. If a sub-bailment is permissible, either by custom of the trade or by express agreement, the terms of the sub-bailment must be consistent with the original bailment. If not, it will have the effect of terminating the original bailment. The bailor may then sue the bailee if the bailee cannot recover the goods from the sub-bailee. In addition, the bailee may be liable to the bailor for any loss or damage to the goods while in the hands of the sub-bailee.

Bailor–Bailee Relationship

The delivery of goods is an essential part of the bailor–bailee relationship. Where the goods are physically placed in the hands of the bailee by the bailor, delivery is apparent. For example, if a library loans a book to a person on the condition that it be returned at a later time, the transfer of possession creates the bailment. However, delivery becomes less clear where the bailee takes only constructive possession of the goods. For example, a businesswoman enters a restaurant and places her coat on a coat-rack located beside her table. Has she created a bailment by the act of placing her coat on the rack that the restaurant has obviously placed there for that specific purpose? The basic requirement for a bailment is delivery of possession. If the coat has

Figure 12–1

Sub-Bailment—Example



not been placed in a restaurant employee's charge, then no bailment may exist. But if the restaurant has either expressly or impliedly requested that the coat be placed upon the rack, then a bailment may have been created by the restaurant. The restaurant under such circumstances may be said to have constructive possession of the goods.

In a bailment, the bailee receives possession only, and at no time would the title to the goods pass to the bailee. The rights of the bailee, nevertheless, once delivery has taken place, are much like those of the owner. The bailee has the right to take legal action against any person who interferes with the property or the bailee's right of possession, and the bailee may also sue any person who wrongfully damages the goods. Any money recovered that relates to damage to the goods, however, must be given to the bailor.

An important duty on the part of a bailee is the return of the goods or chattel to the bailor or to dispose of the goods according to the bailor's directions. The same goods must be returned to the bailor, except goods which are interchangeable commodities, such as grain and other natural food products, fuel oil, gasoline, or other goods that are usually stored in large quantities in elevators or tanks. Goods of the same grade or quality, and in the same quantity, must be returned in that case. If the bailee does not return the bailed goods, the bailor is entitled to bring an action against the bailee for the tort of conversion.

Liability for Loss or Damage

The liability of a bailee for loss or damage to goods while they are in the bailee's possession varies from one type of bailment to another. There are many different general bailment relationships that the courts recognize, and the liability of the bailee differs for each.

Regardless of the standard of care fixed for a bailee, if the bailor can establish that the

bailee failed to return the goods, or if the returned goods were damaged or destroyed (reasonable wear and tear excepted, if the bailee was entitled to use the goods), then the onus shifts to the bailee. The bailee must satisfy the court that the standard of care fixed for the particular kind of bailment was maintained and that the loss or damage was not a result of the bailee's negligence.

The reason for placing the onus on the bailee to show that he or she was not negligent is based upon the fact that only the bailee is likely to know the circumstances surrounding the damage to the goods. The bailor during the bailment would not have any knowledge of how the loss or damage came about, and the courts have accordingly recognized this fact. If the bailee is unable to offer any reasonable explanation for the loss, or if the bailee is unable to establish no negligence, then responsibility for the loss is likely to fall on the bailee.

Bailees in most commercial bailments, such as warehouse storage or truck transport, are expected to maintain a relatively high standard of care, and for this reason, most of these bailees will attempt to limit their liability in the event of loss. The usual method used by bailees to limit their liability is to insert a clause that is known as an **exemption clause** in the bailment agreement. An exemption clause, if carefully drawn and brought to the attention of the bailor before the bailment is made, will generally bind the bailor to the terms of the limited liability (or no liability at all) as set out in the exemption clause. Recent cases, however, have tended to reduce the protection offered by exemption clauses. If the clause is so unreasonable that it amounts to a clear abuse of freedom of contract, the exemption may not be enforced.

Exemption clause
A clause in a contract that limits the liability of a party.

12.2 TYPES OF BAILMENT

Gratuitous Bailment

A **gratuitous bailment** is a bailment that may be for the benefit of either the bailor or the bailee, without monetary reward. In the case of gratuitous bailment, the liability for loss or damage to the goods varies with the respective benefits received by each of the parties to the bailment unless the parties have agreed to the standard of care. If the bailment is entirely for the benefit of the bailor, such as where the bailee agrees to store the bailor's boat without charge during the winter months, then the bailee's liability is minimal. The bailee in such a case may only be obliged to take reasonable care of the goods by protecting them from any foreseeable risk of harm. The actual standard, unfortunately, appears to vary somewhat, depending upon the nature of the goods delivered, with the courts in some cases saying that the bailee need only care for the goods as the bailee would care for his or her own goods.

Gratuitous bailment
A bailment where the bailee makes no charge for the bailment.

Conversely, where the bailment is entirely for the benefit of the bailee (for example, where a bailor gratuitously loans the bailee his automobile), the bailee would be liable for any damage caused to the goods by the bailee's negligence, reasonable wear and tear being the only exception. Where the bailment is for the benefit of both parties, a court may establish a standard of care that falls between these two extremes.

Bailment for Reward

In a business setting, **bailment for reward** includes a number of different bailment relationships. The bailment may be for storage, such as placing goods in the possession of a warehouse operator, or it may take the form of the delivery of goods to a repair facility for repairs. It may also take the form of a rental of equipment (such as an automobile), the transport of goods, or the pledge of valuables or securities as collateral for a loan. Again, the liability of each of these particular bailees varies due to the nature of the relationship that exists between the parties.

Bailment for reward
A bailment where the bailee receives a fee for holding or handling the goods.

Storage of Goods

The storage of goods for reward is a common business activity. In each case, it represents a bailment if possession and control of the goods passes into the hands of the party offering the storage facility. The bank or trust company that rents a safety deposit box to a customer, the marina that offers boat storage facilities, or the storage warehouse that offers to rent space for the storage of goods or equipment are bailees for reward. So, too, are the operators of grain elevators, fuel storage facilities, and parking lots, if the parking lot operator obtains the keys to the vehicle.

Example

A grain dealer purchased 100 tonnes of oats from the farmers in an agricultural area and had the oats stored in a local grain elevator. The delivery of the oats created a bailment with the operator of the grain elevator. Later on, the dealer sold the oats and requested a return of the oats from the elevator. The elevator operator would be required to release 100 tonnes of oats of the same grade or quality as the dealer had stored in order to comply with the terms of the bailment.

Warehouse Storage

A warehouse operator as a bailee is expected to take reasonable care of the goods while they are in the bailee's possession, and the standard is normally that which would be expected of a skilled storekeeper. In other words, the bailee would be expected to protect the goods from all foreseeable risks. If the goods require special storage facilities and the warehouse company holds itself out as possessing those facilities, then the failure to properly store the goods would render the warehouse operator liable for any loss. For example, if a warehouse company holds itself out as the operator of a frozen food warehouse and a bailor delivers a quantity of frozen meat to the warehouse that requires the temperature of the goods to be held at some point below freezing, the failure to store the meat at the required temperature would render the company (as bailee) liable for any loss if spoilage should occur.

The liability of a bailee for storage is not absolute. The bailee is generally only liable if the bailee fails to meet the standard of care fixed by the courts for the nature of the business that the bailee conducts. However, the courts are unlikely to hold the bailee responsible in cases where the loss or damage could not, or would not, have been foreseen by a careful operator.

CASE LAW

A fur storage company accepted a valuable fur coat for off-season storage. The coat was stolen by thieves who managed to break into the building, even though the company had carefully secured the property from forced entry.

The owner of the coat sued the storage company for the value of the stolen coat. In its defence, the storage company argued that it had taken reasonable care to protect the goods from theft.

The issue before the court was whether the company had met the standard of care of a bailee of valuable goods, such as a fur coat.

The court held that the storage company was not an insurer of the goods but only obliged to show that it took reasonable care and was not negligent in its care of the coat.

Longley v. Mitchell Fur Co. Ltd., (1983), 45 N.B.R. (2d) 78.

Warehouse receipt
A document that entitles the holder to claim the bailed goods.

Bill of lading
A contract entered into between a bailor and a common carrier of goods (bailee) that sets out the terms of the bailment and represents a title document to the goods carried.

A contract for the storage of goods will usually involve a document that is known as a **warehouse receipt**. The receipt entitles the person who holds the receipt to obtain the goods from the bailee. This is an important business document, as the owner of the goods often sells the goods while they are in storage and, as a part of the sale transaction, provides the purchaser with the warehouse receipt. The new owner (bailor) may then use the receipt to obtain delivery of the goods from the bailee. The **bill of lading** used by carriers of goods, such as highway transport firms, performs a similar function when goods are shipped to a purchaser.

All provinces have passed legislation that provides for a statutory lien for storage costs that may attach to the goods in the warehouse operator's possession. The legislation generally provides that the warehouse operator may retain the goods until payment is made and may sell the goods by public auction if the bailor does not pay the storage charges. The statutes require special care be taken by the bailee with respect to notice to the bailor and advertisement of the sale to ensure that the bailor has an opportunity to redeem the goods. The statutes also require that the sale of the goods be conducted in a fair manner. The right to a lien, however, is based upon the possession of the goods by the bailee. If the bailee voluntarily releases the goods to the bailor before payment is made, the bailee will lose the right to claim a lien.

Parking Lots

The bailment of a motor vehicle for the purpose of parking the vehicle represents one of the most common short-term bailment relationships. However, it is important to distinguish the true bailment of an automobile from the use or rental of space for parking. Again, the transfer of possession of the vehicle to the parking lot operator is essential to create the bailment. If the operator of the lot accepts the keys to the automobile and parks the vehicle, a bailment is created, as the operator has possession of the bailor's property. Similarly, if the operator of the parking lot directs the person to place the vehicle in a certain place on the parking lot and requests that the keys be deposited with the attendant, the deposit of the keys would also create a bailment.

Example

An automobile owner parked her automobile in a parking lot. She gave her keys to the parking lot operator and received a receipt in return. A bailment was created on delivery of the keys. The receipt or ticket she received contains the terms of the bailment agreement. When she returns to the parking lot and pays for the parking, she is given her keys, at which time she takes possession of her automobile and the bailment ends.

Where the agreement between the parking lot operator and the vehicle owner is one of rental of a space for parking purposes and if the vehicle owner parks the vehicle and retains the keys, possession does not pass from the owner to the operator of the lot. The retention of the keys by the vehicle owner precludes any control over the vehicle by the parking lot operator, and consequently, a bailment does not arise. In these cases, the courts generally view the transaction as an arrangement whereby the parking lot operator licenses the use of the parking space by the vehicle driver on a contractual basis.

Exemption clauses are frequently found in contracts concerning the bailment of vehicles. These clauses usually state that the parking lot operator is not liable for any damage to the vehicle while it is in the operator's possession. The bailee, however, must take steps to bring the bailee's limited liability to the attention of the bailor either before or at the time that the bailment takes place. The simple printing of a limitation of liability on the back of the parking lot

ticket is usually not enough. To be successful, the limitation must be clearly brought to the attention of the bailor, either by direct reference to the limitation or by placing large marked signs in places where they will definitely be seen by the bailor.

CASE LAW

The owner of a motor vehicle drove into a parking lot where the attendant took the keys to the vehicle and gave the owner a receipt. The receipt contained the warning "We are not responsible for the theft or damage to the car or contents however caused." Several large signs at the entrance to the parking lot contained the same message.

When the owner of the vehicle returned to the parking lot, he discovered that his vehicle had been seriously damaged. He sued the parking lot company for negligence.

The court held that a bailment was created by the delivery of the keys to the vehicle but that the bailee was not responsible for the damage, as it had exempted itself from the loss by clearly limiting its liability by the contract (receipt) and the large signs informing the bailor of its limited liability for loss. The court dismissed the bailor's claim.

Samuel Smith & Sons Ltd. v. Silverman (1961), 29 D.L.R. (2d) 98.

Bailment for Repair or Service

Bailment takes place where the owner of a chattel (a computer, for example) that requires service or repair delivers it to the repair facility and leaves it with the proprietor. The proprietor, as a bailee, is expected to protect the goods. Even though no charge is made for the bailment separate from the repair charge, the bailment is, nevertheless, a bailment for reward, and the bailee is expected to take reasonable care of the goods. The standard of care will generally vary according to the nature of the goods. For example, the standard of care would be higher for expensive jewellery or watches than for a small kitchen appliance. If the goods are lost or damaged while they are in the bailee's possession, the bailee may be liable if the loss is due to the bailee's negligence.

If the goods are sub-bailed to a sub-bailee in accordance with the customs of the trade, then the bailee may also be liable for loss or damage to the goods by the neglect or wilful acts of the sub-bailee.

Example

Ashley Car Rentals delivered an automobile to Baker Auto Repair Ltd. for repairs, and Baker Auto Repair, by way of a sub-bailment, placed the car with Ace Ignition Services to have some specialized work done on the vehicle. If Ace Ignition Services negligently damaged the automobile while it was in its possession, Baker Auto Repair would be liable to Ashley Car Rentals for the damage. Ace Ignition Services would be liable to Baker Auto Repair for its negligence.

A bailee who professes to have a particular repair skill is expected to carry out repairs in accordance with the standards set for the skill. The bailee is also expected to meet the standard duty of care of the skill in the protection or handling of the goods. In return, the bailee is entitled to payment that may be either agreed upon at the time the bailment for repair is made or

to a reasonable price for the services when the work is completed. If the bailor refuses to pay for the work done on the goods, at common law, the bailee has a right of lien and may retain the goods until payment is made. If payment is not made within a reasonable time, subject to any statutory requirements that set out the rights of the bailee, the bailee may have the goods sold (usually by public auction) to satisfy the bailee's claim for payment.

Rental of a Chattel

The rental or lease of a chattel is a bailment for reward in which the bailor-owner gives a bailee the possession and use of a chattel in return for a money payment. Automobile and truck rentals would be examples of this type of bailment, but many other kinds of equipment used in business, such as computers, machinery, and tools, are often leased. This type of bailment is usually in the form of a written agreement that sets out the rights and duties of each party.

The rental agreement normally will set out the rental fee and the agreed-upon use of the chattel. If no fee was specified when the agreement was made, then the bailee is required to pay the reasonable or customary price for the use of the goods. If the bailment is for a fixed term, the bailee is usually liable for payment for the full term, unless the bailor agrees to take back the chattel and clearly releases the bailee from any further obligation to pay. Apart from the payment of the rental fee and except for any specific obligations imposed upon the bailee, the bailee is entitled to possession and use of the goods for the entire rental period.

At common law, a bailee must not use the goods for any purpose other than the purpose for which they were intended. The bailee must not sub-bail the goods or allow anyone else to use them unless permission to do so is obtained from the bailor. If the bailee should do any of these without permission, the bailee would become absolutely liable for any loss or damage to the goods. As a general rule, a bailee will only be liable if the bailee fails to use reasonable care in the operation or use of the goods. The bailee would not be liable for ordinary "wear and tear" that may result from use of the chattel unless the agreement specifically holds the bailee responsible.

The responsibility of the bailor under a rental agreement is to provide the bailee with goods that are reasonably fit for the use intended. The goods must be free from any defects that might cause damage or loss to the bailee when the equipment is put into use. If the bailor knew or ought to have known of a defect when the goods were delivered, the bailor may be liable for the damage caused by the defective equipment.

Example

The Egg Factory Inc. leased a truck from Foster Truck Rentals for the purpose of delivering crates of eggs to market. If Foster Truck Rentals knew or ought to have known that the truck had defective brakes and, as a result of the defect, the truck swerved off the road when the brakes were applied and destroyed a load of eggs, Foster Truck Rentals would be liable for The Egg Factory's loss. However, if the defect was hidden and would not be revealed by testing and a careful inspection, Foster Truck Rentals may not be liable.

If the rental goods, such as a chain saw, have an inherent danger or risk associated with their use, the bailor is normally under an obligation to warn the bailee of the danger, or possible dangers, associated with the use. However, where the bailee is licensed or experienced in the use of the equipment, only unusual features or hazards must be brought to the bailee's attention.

Example

Oil Sands Mining Co. leased a large trailer-mounted portable steam cleaning machine for the purpose of cleaning the sticky tar laden soil from its earth moving equipment at a remote mining site. Steam Generation Ltd. delivered the equipment to the site and provided instructions for its operation.

When the Oil Stands Mining Co. employee started the steam generator according to the instructions given, the boiler exploded due to a faulty safety value that Steam Generation Ltd. had installed on the boiler. The employee was injured as a result of the explosion, and the garage housing the equipment was damaged in the fire that followed.

If Oil Sands Mining Co. sued Steam Generation Ltd. for damages, the court would find that the equipment was not reasonably fit for the use intended and hold Steam Generation Ltd. liable for the loss suffered by Oil Sands Mining Co.

Carriage of Goods

The carriage of goods may include a number of different forms of bailment. The carriage of goods involves the delivery of goods by the bailor to the bailee for the purpose of delivery to some destination by the bailee. Apart from a gratuitous carrier, who is usually expected to use reasonable care in the carriage of goods, carriers for reward are usually business entities that fall into two classes: **private carriers** and **common carriers**. The standard of care differs for each.

Private carriers
A carrier that does not normally carry goods as a part of its business.

Common carriers
A business that specializes in the carriage of goods for reward.

A private carrier is a carrier that may occasionally carry goods but is normally engaged in some other business activity. An example of a private carrier might be a taxi operator that is normally in the business of carrying passengers. A company that is a private carrier is free to accept or reject goods as it sees fit. However, if it should decide to act as a carrier of goods for reward, then it would have a duty to take reasonable care of the goods while they are in its possession. For example, a business may hire a taxi to deliver a parcel to one of its customers. In this case, the taxi operator would be expected to take reasonable care of goods until they are placed in the customer's hands.

The common carrier, unlike the gratuitous carrier or the private carrier, carries on the business of the carriage of goods for reward. It offers to accept any goods for shipment if it has the facilities to do so. For example, a trucking company or railway company that engages in the carriage of goods would be classed as a common carrier. Common carriers are to some extent controlled by a statute related to their particular type of business. The statute generally limits the carrier's ability to escape liability in the event that the goods that are carried are lost or damaged. In most cases, the common carrier is essentially an insurer of the goods and is liable for any damage to the goods, except in certain circumstances.

The principal reason for the very high standard of care required of the common carrier is that the goods are totally within the control of the carrier for the entire period of time that the bailment exists. Unlike other forms of bailment (such as a storage facility) where the bailor could presumably check on the goods, once the goods are in the hands of the carrier, they are no longer open to inspection by the bailor until they reach their destination. Under the legislation pertaining to common carriers, the carrier is usually permitted by contract to limit the amount of compensation payable in the event of loss or damage to the goods. The carrier may also avoid liability if the damage to the goods was caused by an act of God, by the improper labelling or packing of the goods by the shipper, or if the nature of the goods was such that they

would self destruct during ordinary handling. Since separate legislation governs railways, trucking firms, and air carriers, the specific liability tends to vary somewhat for each. The basic liability, however, remains the same.

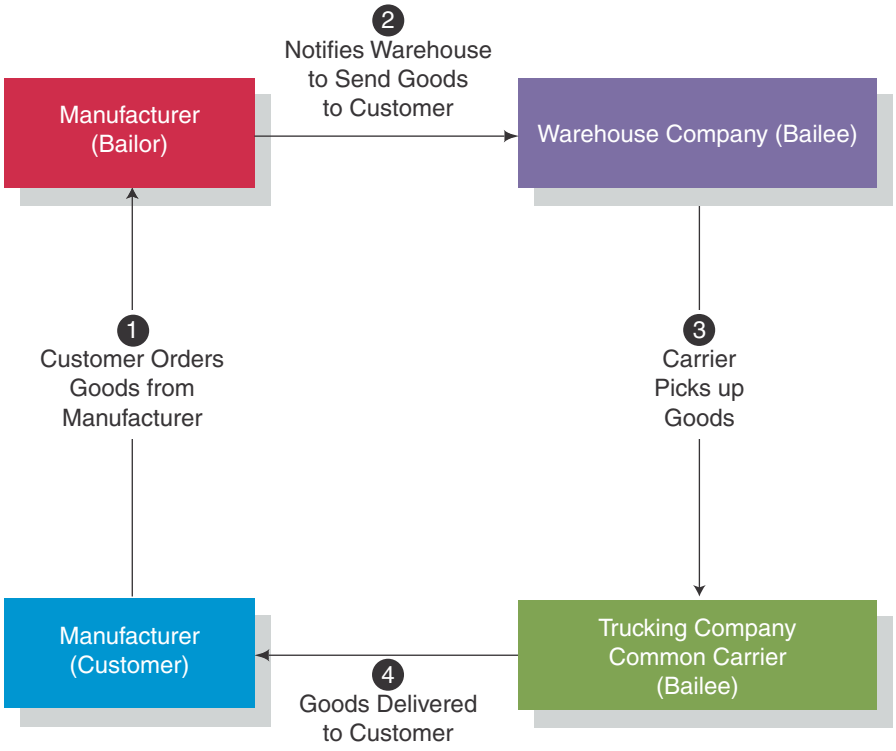
Under a contract of carriage, the bailor also has certain responsibilities. The bailor is obliged to pay the rates fixed for the shipping of the goods. If the bailor fails to pay, the carrier may claim or receive under the terms of the contract the right of lien on the goods until payment is made. If the charges are not paid within a reasonable length of time, the goods normally may be sold to cover the carrier's charges. The bailor is also required to disclose the type of goods shipped and must also take care not to ship dangerous goods by carrier unless a full disclosure of the nature of the goods is made.

A common occurrence in the carriage of goods is a change of ownership of the goods while in the hands of the carrier. The original bailor may be the recipient at the destination where goods are to be shipped, but in most cases, the goods are shipped by the bailor to some other person or business. The contract with the carrier (sometimes called a *bill of lading*) names the business or person to whom the goods are consigned, and the carrier will deliver the goods to the persons or businesses named as consignee. A common business example of this type of contract arises where a person orders goods from a supplier by mail order.

Goods may be shipped under a second type of contract of carriage, called an *order bill of lading*. This is essentially a contract combined with a receipt and document of title that may be endorsed by the consignee, if the consignee so desires, to some other person. An order bill of lading must be given to the carrier in order to obtain the goods.

Figure 12–2

Bailment—Example of Manufacturer Storing Finished Goods with a Warehouse Company Pending Sale



BUSINESS LAW IN PRACTICE

Moving companies are bailees that specialize in the moving of household goods to new locations. The standard practice of these companies is to have an employee examine each item of furniture for marks, scratches, or damage and note the damage on a form that lists each item and becomes a part of the contract. A careful furniture owner should also examine each item and agree with the damage assessment before signing the contract. In this manner, any new damage caused to the furniture in transit may be determined. Compensation for the new damage may then be recovered from the moving company.

Pledge of Personal Property as Security for Debt

Bailment occurs in debt transactions where a bailor delivers personal property to a creditor to be held as security for a loan. The usual personal property used in these transactions are securities, such as bonds, share certificates, or life insurance policies. These securities may be held by the creditor as collateral to the loan. Because the creditor takes possession of the securities, the transaction represents a bailment, and the creditor, as a bailee, would be responsible for the property while in its possession. When the debt is paid, the same securities must be returned to the bailor. The delivery of securities or similar personal property to the creditor as security for a loan is called a **pledge**. If the bailor-debtor should default on the loan, the bailee-creditor may sell the securities pledged to satisfy the debt. Where securities are sold for this purpose, the creditor would be obliged to pay over to the debtor any surplus received on the sale of the securities, as the surplus funds would belong to the debtor.

Pledge
The transfer of securities by a debtor to a creditor as security for the payment of a debt.

Example

Ivan has a $10,000 Canada Savings Bond and wishes to borrow $8,000 from his bank to purchase a snowmobile. Ivan may take his bond to the bank and use it as security for the loan. The bank will hold the bond until the loan is repaid. When the loan is repaid, the bank will return the bond to Ivan.

Innkeepers

An inn, by definition is an establishment that offers both meals and lodging to guests of the inn. In most cases, these would be hotels that offer not only accommodation to travellers but also have restaurant facilities. Historically, at common law, an **innkeeper** was responsible for any goods brought into the inn by a guest that were lost or stolen except where the loss was due to the guest's negligence. The relationship was not a bailment because the guest also had some control over his or her own property. The relationship today is now covered by statute. Innkeepers are required to post the part of the statute pertaining to liability for loss in all hotel rooms and public areas. If the innkeeper does so, then the liability for loss or damage to a guests goods is limited. This amount varies from province to province but, in most cases, ranges from $40 to $100.

Innkeeper
An establishment that offers food and lodging to travellers.

Innkeepers, however, are also required to provide safe keeping for a guest's valuables. This is usually in the form of a security safe or vault where the guest's valuables may be stored. If the innkeeper does not provide this safekeeping service, or refuses to accept a guest's valuables for

safekeeping, the innkeeper would be liable if the goods were lost or stolen. Valuables placed in the hands of the innkeeper for safekeeping would constitute a bailment, and if the valuables were stolen while in the innkeeper's possession, the innkeeper may be held liable for the loss.

Learning Goals Review LEARNING GOALS REVIEW

- A bailment is created by the delivery of a chattel by a bailor (usually the owner) to a bailee to hold the goods for a specific purpose and to later return the goods or dispose of them according to the bailor's instructions.
- Bailment may be gratuitous or for reward.
- A bailee has an obligation to care for the goods, but the standard of care varies. It is high for a bailee for reward (such as a warehouse operator) and lowest for a gratuitous bailee, who receives no benefit from the bailment.
- A common carrier has the highest duty of care and is virtually an insurer of the goods.
- Innkeepers have a statutory duty of care for a guest's goods and an obligation to store guest's valuables in a safe or vault.

12.3 INSURANCE

Bailment is used by business firms to protect their property by using bailees to provide safe storage of goods, or the safe delivery of goods to customers, but businesses and their properties are exposed to many other risks. To protect against these risks, businesses use insurance.

12.4 FORMS OF INSURANCE

Insurance from a business point of view is a means by which a business (or person) may avoid a financial loss by shifting the risk of the loss to an insurance company. Insurance may be obtained to provide compensation when unforeseen events occur that cause loss, damage, or financial injuries to a business, such as fire, theft, business interruption, the death of key personnel, or accidents.

The relationship between the person or business (called the *insured*) and the insurance company (called the *insurer*) is contractual. The contract (called a *policy*) will specify the particular events that the insurer will protect against, for example, fire or theft. In return for the payment by the insured of a sum of money (called a *premium*), the insurer will compensate the insured for the financial loss suffered by the insured if the event named in the policy should occur. Insurance policies are written for a fixed period of time and may be renewed.

Example

An insurance company and a business may enter into an insurance contract whereby the insurance company will insure the warehouse of the business against loss by fire. If the warehouse is worth $500,000 and insured for $500,000, if the building should accidentally catch fire and burn to the ground, the insurer would pay the business $500,000 to have the building rebuilt or replaced.

Insurance is based upon statistical calculation of the likelihood that a particular loss will occur. Insurers have kept records of accidents, fires, and other events over a long period of time and use this information to determine how often different types of losses might occur. This information enables insurers to establish the amount of money (the premium) they require from each insured in order to maintain a fund to cover losses when they occur. These funds are invested by the insurer, and the income earned is included in the fund to cover the insurer's expenses and profits and to reduce the amount of the premiums that the insured must pay for the insurance coverage.

Fire Insurance

Fire insurance is designed to indemnify a person with an interest in property for any loss that might occur as a result of fire. Any person with an interest in the property may protect that interest by fire coverage. For example, the owner of the property and any secured creditors or tenants (to the extent of their interest) may obtain this form of protection. Fire coverage is not limited to buildings only, as equipment and chattels contained in a building may also be insured. Fire policy protection is normally extended to other damage caused as a result of the fire, as in the case of smoke and water damage, and may also insure against acts of God, such as lightning strikes that cause damage.

Life Insurance

Life insurance is insurance on the life of a person. It may be taken out on one's own life or on the life of another person in which one has an insurable interest. For example, a creditor may take out insurance on the life of a debtor to ensure that the loan will be repaid if the debtor should die. Life insurance is different from other forms of insurance in that the insurer must eventually pay the face value of the insurance policy in force at the time of death of the insured person. Statistical data on the probable life span of individuals, called actuarial tables, are used to determine the likelihood of loss due to the premature death of policy holders and to determine the premium required to cover this unexpected event. The tables are also used to calculate the expected pay-out of the value of the policy, if the policy holder dies at the end of a normal life span.

Some life insurance policies may be used for investment purposes as well as for protection of the beneficiaries in the case of the unexpected death of the insured. For life insurance of this type, the premiums include not only an amount to cover the cost of coverage for an unexpected loss of life but also an amount to be invested to provide the insured with a sum of money at the end of a specified period of time.

An important part of a life insurance policy is the application for the insurance, in which the insured sets out all the information required by the insurer to determine if the risk should be accepted, and if so, the premium payable for assuming the risk. The application is usually incorporated in the policy and becomes a part of the contract. Fraudulent statements by the applicant in the application generally permit the insurer to avoid payment under the policy when the fraud is discovered.

Provincial legislation generally does not determine the specific kinds of policies that a life insurer may issue but specifies the terms that must be included in the policy with respect to lapse, renewal, proof of death of the insured, and time for payment of the insurance proceeds. The legislation also covers other aspects of the operation of life insurance companies, including strict rules regarding the investment of their funds, in order to make certain that the companies remain solvent and able to pay all claims under the policies.

Sickness and Accident Insurance

Insurance for sickness and accident represents a type of insurance that protects against or reduces the income loss that a policy holder might suffer through sickness or accident. Employers will often arrange for this type of insurance for their employees on a group basis as an employee benefit. The amounts payable may vary, but the upper limits on the amounts payable are usually less than the insured person's normal income. Accident benefits that cover loss of limb, eyesight, or other permanent injuries are generally fixed in the policy at specific dollar amounts. As with other forms of insurance (other than life), this type of insurance is designed to provide compensation only for the loss suffered.

Liability and Negligence Insurance

Liability and negligence insurance is designed to indemnify a business or person where claims are made by others for losses due to negligence by the person, the business or its employees in the performance of their work. Of the many forms of negligence or liability insurance, automobile insurance has become so important and its use so widespread that it is treated separately under insurance legislation in most provinces. Some provinces maintain their own compulsory government administered automobile insurance schemes.

Liability insurance is normally used to protect against claims of loss arising out of the use of premises (i.e., occupier's liability), manufacturer's product liability, professional negligence, and business liability for the acts of employees or agents. More recently, many firms have turned to insurance as a means of protection from claims under environmental laws. Policies may be obtained to cover the clean-up costs of environmental accidents, such as product spills causing ground or water pollution, pollution damage caused by manufacturing processes of the insured, or the insured's negligence in the design of products for others, which, in turn, causes environmental damage.

Most professional persons carry liability insurance to cover professional errors and omissions. For example, professional accountants and lawyers carry liability insurance to cover errors or omissions they may make in the performance of their work on behalf of clients or on the advice they may offer. Engineers, architects, and other professionals may also obtain coverage for errors they might make in the conduct of their professional duties, and physicians and surgeons generally obtain coverage for claims that may arise out of the improper treatment of patients' illnesses or the failure to perform medical procedures in accordance with accepted standards of care.

Special Types of Insurance

In addition to these general forms of insurance coverage, insurance is also available for many specialized purposes. For example, insurance policies may be obtained to protect an employer from an employee's dishonesty, for theft or loss of goods, for business interruption, for ships and cargo, and for a variety of specific business activities. All of these have one characteristic in common, they are designed to indemnify the insured in the event of a loss or in a claim for compensation.

The Nature of an Insurance Policy

The contract of insurance, as the name implies, is a contractual relationship to which the general rules of contract and a number of special rules, apply. It is treated by the courts as a contract of utmost good faith. This means that the applicant for insurance must disclose all information requested by the insurer to enable the insurer to decide if it should assume the risk. The

insurer–insured relationship has also been the subject of much control through legislation. Each province has legislation governing the contract of insurance in its various forms, and with the exception of the Province of Quebec, the legislation has tended to become uniform for most types of insurance. A number of provinces have special legislation that provides for provincially controlled automobile insurance or for "no-fault" insurance for automobile accident cases. For the remainder, the general legislation and the common law rules apply.

Riders (endorsements)
A clause altering or adding coverage to a policy.

Changes in standard form contracts are effected by **riders** or **endorsements** that represent changes or additions to the standard terms and coverage in the agreement. A *rider* is an additional clause attached to the contract that adds to, or may alter, standard form coverage. A rider is normally included in the agreement at the time the contract is written. An *endorsement* is a change the parties agree to make to an existing contract and, to save rewriting the contract, is simply attached to it.

A liability insurance contract is a special type of contract in the sense that the insured receives nothing until the insured suffers some loss. Even then, the insured will only receive a sum that will theoretically place the insured in the same position that it was in before the loss occurred. The exception is life insurance, where the insured must die for the money to be collected, but even with life insurance, payment is not made unless the insured suffers the loss.

Insurable interest
An interest that would result in a loss on the occurrence of the event.

The loss that the insured suffers must relate to what is known as an **insurable interest**. This interest must be present in every insurance contract. It may be defined as anything in which the insured has a financial interest that on the occurrence of some event might result in a loss to the insured. An insurable interest may arise from ownership or part-ownership of personal property (such as an automobile or truck) or real property or a security interest in either of them, or it may be one's own life, the life of one's spouse or child, or the life of a debtor or anyone in whom a person may have a financial interest (for example, a partner or a key employee). It may also arise out of a person's profession or activity to protect income or assets. Most insurers, however, will not insure persons against the wilful acts that they commit against themselves or against their insured interests. For example, an insured person may not obtain fire coverage on a home, then deliberately burn the premises to collect the insurance proceeds. Nor would an insurer normally be obliged to pay out life insurance on the life of an insured who committed suicide. It should be noted, however, that under insurance legislation in some jurisdictions, the beneficiaries may be entitled to the insurance proceeds in the case of a suicide where the policy has been in effect for some time.

In general, an insurable interest is anything that stands to benefit the insured person by its continued existence in its present form and that, if changed, would represent a loss. With the exception of life insurance, the insurable interest must exist both at the time the contract of insurance is made and when the event occurs that results in a loss.

Example

The Acme Corporation placed a policy of insurance on a building that it owned, then later sold the building for cash but did not cancel the fire insurance policy on the building. The building was subsequently destroyed by fire. The corporation would not be permitted to collect the insured value of the building. By selling the building, it no longer had an insurable interest in the property at the time of the loss. Nor would the purchaser be entitled to recover under the Acme Corporation policy because the purchaser was not a party to the insurance contract.

In the case of life insurance, the person who takes out a policy of insurance on the life of another need only establish an insurable interest in the life of the person at the time the policy

of insurance was issued. For example, if a bank arranged for insurance on the life of a business person indebted to it, the creditor bank could show an insurable interest at the time of issue of the policy. The creditor, however, need not establish an insurable interest at the time of the debtor's death to receive the proceeds of the policy.

The contract of insurance, as a contract of utmost good faith, requires full disclosure on the part of the applicant for the insurance of all material facts. The right of the insurer to be informed of all material facts is important because the insurer is undertaking a risk that is frequently determined from the information supplied by the applicant for the insurance. For this reason, honesty on the part of the applicant is essential. If the applicant fails to disclose material facts, then the insurer may later refuse to compensate the insured if a loss occurs. For example, if the true owner of a motor vehicle arranges with a friend to have the vehicle registered in his name for the purpose of obtaining insurance, the insurance protection may not extend to the true owner, if the true owner was driving the vehicle at the time of an accident for which he was responsible.

At common law, the nondisclosure or misrepresentation of a material fact would entitle the insurer to later avoid liability when the nondisclosure or misrepresentation was discovered. This rule has been altered to some extent by statute, but for the most part, the rule still holds. The exception that the legislation makes generally relates to innocent misrepresentation or innocent nondisclosure. However, where the nondisclosure or the misrepresentation amounts to fraud, then the common law rule would apply.

The justification for this legislative change is based upon the possible unfairness of an insurer refusing payment of a loss where the insured without intention to deceive failed to disclose a fact or stated an untruth that he or she honestly believed to be true. To avoid the harsh common law requirements for a contract of utmost good faith, the legislation usually requires the insurer to carry out the policy terms if the policy has been in effect for a considerable period of time before the loss occurs (usually several years). For example, Ontario legislation provides that innocent nondisclosure by an applicant for life or health and accident insurance may not be a basis for the insurer to avoid payment of a claim made if the policy has been in force for a period of more than two years. This change in the law also recognized the fact that the beneficiaries of the insured under a life policy would suffer as a result of the insured's innocent nondisclosure.

BUSINESS ETHICS

The line between innocent misrepresentation and fraud is sometimes difficult to determine on an application for insurance, particularly if the information is critical in the determination of insurability of the risk. Insurers often provide a warning concerning accuracy of the information on application forms, but these forms are often filled in by agents and simply signed by the applicants. In fairness to both the insurer and the applicant, the agent should advise the applicant of the importance of accuracy and the consequences that might follow if the information supplied by the applicant is incorrect.

Change of Risk

Because a contract of insurance relates to an ongoing relationship, the policy usually requires the insured to advise the insurer of any substantial changes in the risk. Notification to the insurer when an insured makes changes to property or the type of business operated is important, as

any change in the risk, if significant, could affect the liability of the insurer to pay if loss occurs. Notification of the change permits the insurer to decide if it wishes to insure the changed business activity, and if so the premium to charge.

Fire insurance policies usually require the insured to notify the insurer if the insured premises will be left unoccupied for more than a specified period of time. Insured business firms are expected to notify the insurer if the risks associated with the conduct of the business change substantially. For example, if a manufacturer of chemical fertilizer decides to change its product line to include the manufacture of explosives or some other dangerous product, it would be obliged to notify the insurer that a new, higher-risk activity was to take place on the premises.

CASE LAW

A motorist obtained a policy of insurance for his automobile that required him to notify the insurer of "any change of risk." At the time that he took out the insurance, his driver's license was valid and his license had not been suspended for any reason in the three preceding years. The motorist renewed his insurance for several years. During the next year, a driving violation resulted in a suspension of his license for a period of months, and when his insurance came up for renewal, he did not reveal the license suspension to the insurer. The insurer renewed the policy, and shortly thereafter, the motorist was involved in a motor vehicle accident.

The insurer at that point in time discovered the motorist's previous license suspension and refused to pay the insurance claim. The motorist then sued the insurer.

The court held that the contract of insurance required the motorist to notify the insurer of "any material change of risk" and that a license suspension represented a material change of risk. The motorist's failure to notify the insurer was a breach of the insurance contract, and the insurer was not required to pay the claim.

Swimmer et al. v. Corkum: Prudential Assurance Co. Ltd. 3rd Party (1978), 89 D.L.R. (3d) 245.

The above case illustrates the importance of full disclosure by an applicant for insurance and the good faith nature of the contract of insurance.

12.5 THE CONCEPT OF INDEMNITY FOR LOSS

A special feature of a contract of insurance is the fact that it is a contract of indemnity. With the exception of life insurance and, to some extent, accident insurance, all contracts of insurance prevent the insured from making a profit from a loss. A number of special insurance concepts ensure that the insured business will only be placed in the position that it was in before the event occurred that caused the loss. For some forms of loss, which concern third parties, no special protection is needed for the insurer.

Example

The owner-driver of an automobile injured a pedestrian by her negligence. The owner-driver's insurer will compensate the pedestrian for his loss or pay any judgement that the pedestrian might obtain against the owner-driver for her carelessness. Only the injured party will be compensated and only for the actual loss suffered.

With respect to property owned by the insured, three special rights of the insurer apply in the event of loss in order to prevent the insured from receiving more than the actual loss sustained. If the property is not completely destroyed, the insurer has the option to repair the property or pay the insured the full value of the property at the time of loss. In the case of a chattel, if the insurer pays the insured the value of the chattel, then the insurer is entitled to the property. This particular right is known as **salvage**, and it gives the insurer the right under the policy to demand a transfer of the title to the damaged goods.

Salvage
The right of an insurer to claim insured goods where it has paid the insured the value of the goods.

Example

McKay Taxi Ltd. owns a number of automobiles insured by the Car Insurance Company. One of the insured automobiles is involved in an accident and is badly damaged. If the Car Insurance Company compensates McKay Taxi Ltd. for the value of the automobile, then McKay Taxi Ltd. must deliver up the damaged automobile to the insurer in return for the payment. The insurance company may then dispose of the wreck to reduce the loss that it has suffered through the payment of the McKay Taxi Ltd. claim.

Salvage rules would also apply where goods are stolen from the insured. If the insurer pays the insured the value of the stolen goods and if the goods are subsequently recovered, the goods will belong to the insurer and not the insured. By the terms of the policy of indemnity, the goods become the goods of the insurer when the claim is paid. In effect, the payment of the claim is the equivalent to a purchase of the goods by the insurer.

Subrogation
The substitution of parties whereby the party substituted acquires the rights at law of the other party, usually by way of contractual arrangement.

The right of **subrogation** is an important right granted to an insurer in a policy of insurance. Subrogation is the transfer to the insurer of the right of the insured to take legal action to recover damages for loss where the insurer compensates the insured for the loss. Subrogation arises where the insured is injured or suffers some loss due to the actionable negligence or deliberate act of another party.

Example

An insured aircraft is damaged by the negligence of a fuel delivery truck driver. The owner of the aircraft would have a right of action against the truck owner-driver for the damage caused by the driver's negligence. If the insurer of the aircraft compensates the owner for the damage to the aircraft, then, by the doctrine of subrogation, the insurer is entitled to take the owner's right of action against the negligent party.

Contracts of insurance usually include a subrogation clause that specifically provides that the insured grants the insurer the right to proceed against the party causing the injury to the insured, or it may require the insured to proceed against the wrongdoer on behalf of the insurer, if the insurer pays the insured for the loss that the insured has suffered.

The doctrine of subrogation is an important insurance concept. Without the right of subrogation, an insured could possibly obtain payment for double the amount of the loss suffered: once from the insurer under the contract of insurance and a second amount in the form of damages by taking legal action against the negligent party for the injury suffered. The right of subrogation prevents double payment to the insured and places the liability for the loss upon the person responsible for it. The right of the insurer to recover losses from a negligent party is also

a benefit to the insured, as it substantially reduces the premiums that insured persons or businesses must pay for insurance coverage.

Contribution
The right of insurers to share the amount of the loss even though each insured the full value of the loss.

A further limit on the insured's compensation to the actual amount of the loss is the right of **contribution** between insurers. Insured businesses or persons sometimes have more than one policy of insurance covering the same loss. However, if the policies contain a clause that entitles the insurer to contribution, then each insurer will only be required to pay a portion of the loss.

Example

If an insured business has insurance coverage with three different insurers against a specific loss, and suffers a loss of $60,000, the insured will not be permitted to collect $60,000 from each of the insurers. The insured business will only be entitled to collect a total of $60,000 from the three (i.e., $20,000 from each). Each insurer would only be required to pay its share of the loss suffered by the insured.

The insured under some policies of insurance may become an insurer for a part of the loss if the insured fails to adequately insure the risks. Because the likelihood of a total loss may sometimes be small for certain risks, an insured may be tempted to take out only a small amount of insurance to cover the risk and thereby pay a lower premium. In these cases, the insurer may, in the policy of insurance, require the insured to become a *co-insurer* in the event of partial loss. A minimum amount of insurance will usually be specified in the policy, and if the insured fails to maintain at least that amount, then the insured becomes a co-insurer for the amount of the deficiency. For example, if a policy contains an 80-percent co-insurance clause, then the insured must maintain insurance for at least that amount of the actual value of the property (or if the insurance is burglary insurance, not less than a stated sum). If a partial loss occurs, then the formula calculation would be:

$$\frac{\text{actual amount of insurance carried}}{\text{minimum coverage required}} \times \text{loss} = \text{insurer's contribution}$$

Example

Co-insurance clause
A clause that may be inserted in an insurance policy that renders the insured an insurer for a part of the loss if the insured fails to maintain insurance coverage of not less that a specified minimum amount or percentage of the value of a property.

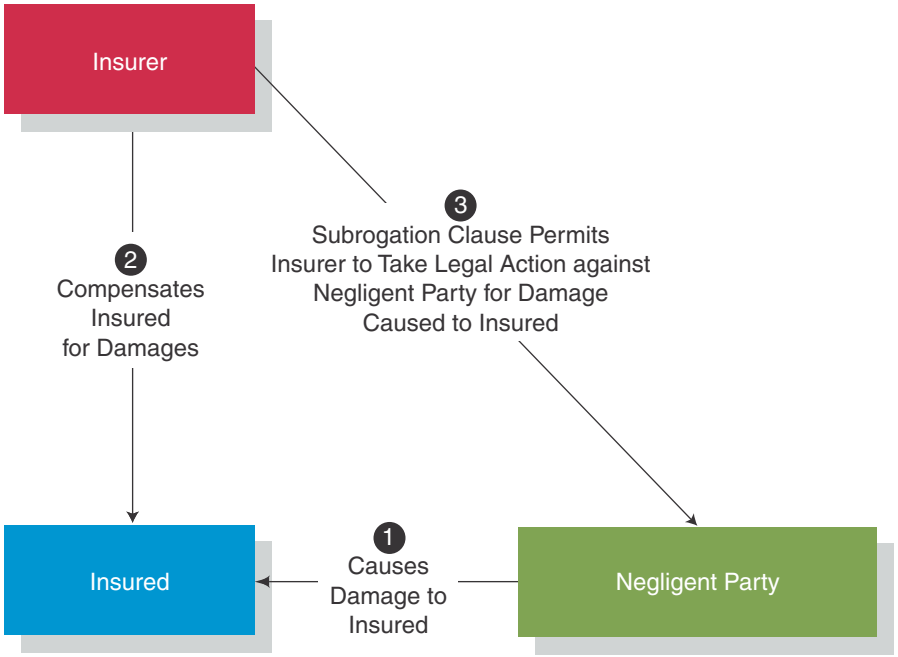
A property has an actual value of $500,000, and the insurance coverage is $300,000. A loss of $100,000 would be calculated as follows if the policy contains an 80-percent **co-insurance clause** (80% of $500,000 = $400,000 minimum coverage required).

$$\text{insurer's contribution} = \$100{,}000 \times \frac{\$300{,}000}{\$400{,}000} = \$75{,}000$$

The insurer in this case would only be obliged to pay $75,000 of the $100,000 loss. Since the insured failed to maintain a minimum of 80 percent coverage, the insured would be required to absorb the remainder of the loss ($25,000) as a co-insurer. Note, however, that if the loss had exceeded $300,000, then the full amount of the insurance would be payable by the insurer. This is so because co-insurance only applies where the partial loss is less than the minimum required amount of insurance coverage.

Figure 12–3

insurance—Subrogation



MEDIA REPORT

The High Cost of No-Fault Insurance

No-fault insurance has created a new industry—that of the "accident consultant." This person cruises along the highways looking for traffic accidents or accepts paid referrals from tow-truck drivers. For a fee, the accident consultant manages the eventual no-fault claim against the insurance company, arranging a wide variety of elements. These elements include auto-body service, rehabilitation clinic treatment, physical therapy, acupuncture, and legal representation. The overall cost paid by Canadian insurers in the past 12 years on such accident claims has increased from $308 million to $1.5 billion, translating into substantially higher insurance premiums. Many in the industry fear that significant proportion of these claims may be fraudulent or that minor accidents are made out to be far more serious than they really are.

For their part, insurance regulators feel that such consultants are presently governed by no one and are answerable to no one, and must, therefore, be made answerable to the regulators for any abuses. Towing operators are concerned that their profession is getting a terrible reputation, and their good and often-dangerous work is unrecognized. Accident consultants take the position that they are simply helping victims receive entitled compensation.

If no-fault insurance means an end to court examination of accident liability, should legislatures act further to maintain integrity and confidence in the insurance industry? What should they do?

Based on: Peter Cheney, "A paralegal and a tow-truck driver are about to make a deal—Guess who winds up paying?" *The Globe and Mail*, August 2, 2003, p. 1.

12.6 THE PARTIES ASSOCIATED WITH INSURANCE CONTRACTS

Apart from the insurer and the insured, a number of other parties may be involved in either the negotiation of the contract of insurance or the processing of claims under it. Most

insurance is negotiated through agents or employees of the insurer, and these persons may have varying degrees of authority to bind the insurer in contract. Agents are generally agents of the insurer and are liable to the insurer for their actions. However, in cases where the insured has relied on the statements of the agent that the policy written by the agent covers the risks that the insured wished to have insured and this later proves not to be the case, the insured may have a cause of action against the agent if a loss should occur.

CASE LAW

A corporation requested an agent for an insurance company to insure its plant, equipment, and operations. The corporation specifically requested coverage for certain kinds of risk, and the agent in arranging the insurance assured the corporation that the specific coverage was included in the policy. The agent, however, had failed to include coverage of the specific risks, and later, when a loss occurred, the corporation discovered that the risks were not covered in the policy.

The corporation took legal action against the agent for failing to provide the coverage, and the court found that the agent was liable for the loss. In finding the agent liable, the court concluded that the agent failed in his duty to provide the coverage bargained for by the insured.

Fine's Flowers Ltd. et al. v. General Accident Assurance Co. of Canada et al. (1974), 49 D.L.R. (3d) 641.

Brokers
A business that will assess risk and then arrange appropriate coverage for a client.

Insurance adjuster
A person or business employed by an insurer to investigate claims of loss by the insured.

Brokers may also place insurance with insurers. They may act either for the insured or the insurer. A business with complex insurance needs may use a broker to determine the various kinds of insurance that it requires. The broker will determine the risks and then arrange for the appropriate coverage by seeking out insurers who will insure the risks for the client.

Insurance adjusters are persons employed by an insurer to investigate the report of loss by an insured and determine the extent of the loss incurred. Insurance adjusters report their findings to the insurer, and on the basis of the investigation, the insurer will settle insurance claims. When, as a result of the adjuster's investigation, the issue of liability is unclear, the insurer may carry the matter on to the courts for a decision before making payment for the loss.

However, an insurer must have good reason to refuse payment of an insured loss, and cannot simply use the court process to delay payment.

Example

In 1994, a fire destroyed the insured home of a family. Insurance investigators ruled out arson, and the Insurance Crime Prevention Bureau confirmed the investigators' findings. Nevertheless, the insurance company refused to pay the insured for their loss. The insured sued the insurance company, and the case went through the appeal process and, by 2002, to the Supreme Court of Canada.

The Supreme Court of Canada concluded that the insurer had no valid reason to refuse payment of the claim. The court not only directed the insurer to pay the insurance claim of $345,000 but awarded the insured punitive damages in the amount of $1,000,000 and court costs in the amount of $300,000.

Learning Goals Review LEARNING GOALS REVIEW

- Business firms use insurance to protect against loss from unforeseen events.
- An insurance policy is a contract between an insurer and an insured whereby the insured will be compensated for monetary losses arising from the occurrence of named risks in the contract.
- Insurance is a relationship based upon utmost good faith.
- Insurance is designed to compensate for losses only, and salvage, contribution, and subrogation prevent an insured from profiting from a loss.
- Co-insurance prevents an insured from underinsuring a risk.

SUMMARY

- A bailment is created by the delivery of possession of a chattel by the bailor (who is usually the owner) to a bailee.
- Bailment involves the transfer of possession and not title, but a bailee may exercise many of the rights normally exercised by an owner while the goods are in its possession.
- Bailment may be either gratuitous or for reward.
- Liability is least for a gratuitous bailee who receives no benefit from the bailment. It is highest for special forms of bailment for reward, such as the common carrier of goods, where the bailee is essentially an insurer for any loss or damage.
- If the agreement between the parties permits a sub-bailment, the bailee may make such a bailment. The bailee may also do so in some cases where sub-bailment, in the absence of an agreement to the contrary, may be made by custom of the trade.
- Bailment for reward may take the form of bailment for storage, for the carriage of goods, the deposit of goods for repair, the hire of a chattel, or the pledge securities to secure a loan.
- A bailee may limit his or her liability by an express term in the contract. Legislation governing bailees, such as warehouse operators, and carriers of goods, contain specific provisions and limitations that generally govern these special bailment relationships.
- With the exception of life insurance, the contract of insurance is a special type of contract designed to indemnify an insured if the insured should suffer a loss insured against in the insurance policy. The insured must have an insurable interest in the property or activity.
- The contract of insurance is a contract of utmost good faith, and full disclosure of all material facts must be made to the insurer if the insured wishes to hold the insurer bound by the policy.
- Life insurance differs from other forms of insurance in that it is not payable to the person on whose life it is placed.
- Because insurance (except life insurance) is designed only to indemnify the insured for losses suffered, the insurer is entitled to the rights of salvage, subrogation, and contribution to limit the loss that it suffers as an insurer.
- Where an insured underinsures, some policies also make the insured a co-insurer for partial losses.

KEY TERMS

bailee (page 316)
bailment (page 316)
bailment for reward (page 318)
bailor (page 316)
bill of lading (page 320)
broker (page 335)
co-insurance clause (page 333)
common carrier (page 323)
contribution (page 333)
exemption clause (page 318)

gratuitous bailment (page 318)
innkeeper (page 325)
insurable interest (page 329)
insurance adjuster (page 335)
pledge (page 325)
private carrier (page 323)
rider (endorsement) (page 329)
salvage (page 332)
sub-bailment (page 316)
subrogation (page 332)
warehouse receipt (page 320)

REVIEW QUESTIONS

1. Define a bailment.
2. Explain the term *constructive bailment.*
3. How is the standard of care of a gratuitous bailee determined?
4. What rights over a bailed chattel does a bailee possess? Why are these rights necessary?
5. Why do the courts impose a greater responsibility for the care of goods on a common carrier than upon a gratuitous carrier?
6. Indicate the "defences" available to a common carrier in the event of loss or damage to goods in the carrier's possession.
7. What standard of care is imposed on a bailor in a hire of a chattel?
8. What essential element distinguishes the rental of space in an automobile parking lot from a bailment of the vehicle? How does this affect the liability of the owner of the parking lot?
9. Indicate the effectiveness of an exemption clause in a bailment contract for the storage of an automobile. How do the courts view these clauses?
10. To what extent is a bailee for reward entitled to claim a lien for storage costs against the goods?
11. Explain: (a) pledge, (b) sub-bailment.
12. What is an innkeeper's responsibility to its guests? Is it a bailment?
13. Explain an insurable interest as it applies to a contract of insurance.
14. Why is a contract of insurance a contract of utmost good faith?
15. What right of the insurer prevents an insured party from making a profit by a loss?
16. Is it possible for a creditor to insure the life of a person indebted to him or her? Explain.
17. Explain the doctrine or concept of salvage. Give an example of how it might apply.
18. In what way does the right of subrogation ultimately benefit the insured?
19. Describe the right of contribution, and, by way of example, show how insurance companies use it to determine their liability.
20. What mathematical principles are used to determine premium rates for life insurance policies?
21. A creditor insured the life of a debtor to cover the amount of the debt owed. Two years later, the debtor died, having paid back over half the debt. Is the creditor entitled to the full amount of the policy?

DISCUSSION QUESTIONS

1. In the Cabinet Manufacturing Ltd. scenario at the beginning of this chapter, the plant manager was directed to seek advice from the company lawyers concerning a contract with a nearby warehouse for the storage of inventory. What questions should the plant manager ask in order to obtain the advice needed to proceed with the contract? Given the nature of the relationship with the warehouse operator, what steps should the company take to reduce and shift its risks in the venture?
2. A retailer of electronic consumer goods developed a number of kits for the building of small electronic devices, such as small AM/FM radios, sound amplifiers, and digital clocks. Initially, these kits were sold through its retail store, but it has decided to sell them by mail order or through the Internet. What issues will this decision raise with respect to bailment and insurance?

DISCUSSION CASES

Case 1

Sharon parked her automobile in a parking lot owned by the Parking Corporation. At the request of the parking lot attendant, she left her keys at the attendant's office and received a numbered ticket as her receipt for the payment of the parking fee. The ticket had the following words written on the back: "Rental of space only. Not responsible for loss or damage to car or contents however caused." A 50-cm^2 sign on the side of the attendant's office contained a similar message. Before leaving her keys with the attendant, she made certain that the doors of the vehicle were securely locked, as she had left a box containing her camcorder and computer in the trunk of the car.

Sharon was not aware that the attendant closed his ticket booth at midnight, at which time he delivered the keys to the cars on the lot to the attendant of the parking lot across the street. The adjacent lot was also owned by the corporation, but it remained open until 2:00 a.m.

Sharon returned to the parking lot to retrieve her automobile shortly after midnight, at which time she discovered no attendant in charge and her vehicle missing. By chance, she noticed an attendant on duty at the parking lot across the street and reported the missing vehicle to him, only to find the attendant in possession of her keys.

The police discovered Sharon's automobile a few days later in another part of the city. The vehicle had been damaged and stripped of its contents, including her camcorder and computer.

Sharon brought an action against the Parking Corporation for her loss.

Identify the issues in this case, and prepare the arguments that Sharon and the Parking Corporation might use in their respective claim and defence. Render a decision.

Case 2

Restaurant Supply Co. was an importer of various lines of cutlery, utensils, and tableware that it sold in quantity to hotels and restaurants. Approximately 50 percent of its sales consisted of hotel-grade dishes, and the remaining 50 percent consisted of cutlery and cooking utensils.

Restaurant Supply Co. used the services of Commercial Transport Ltd. to deliver its goods to customers who were located in various parts of the country. All goods were shipped in cartons, but those containing dishes were normally packed in a straw-like material to provide protection in the event of impact or careless handling and were marked "Fragile." This reduced breakage of the shipped dishware to a minimum acceptable level. Only occasionally would a customer report breakage, and this usually consisted of only one or two dishes in a shipment of perhaps many hundreds of pieces.

Restaurant Supply Co. recently tested a new type of foam packing material and decided that its use would permit the contents of a case to withstand a reasonable amount of impact if the case should accidentally be dropped. Management then decided to use the new packing material in cartons that were not marked with a "fragile" label in order to obtain a lower shipping rate. The company informed Commercial Transport Ltd. of the removal of the "Fragile" notice on the containers and requested a lower shipping rate, and Commercial Transport Ltd. agreed to handle the goods at a lower rate.

During the month that followed, management of Restaurant Supply Co. monitored the breakage rate and noted that it was approximately the same as when the other marked containers were used. The next month the company shipped a very large quantity of dishes to a distant hotel customer in 40 of the new containers. When it was received by the hotel, almost one-third of the dishes were found to be either cracked, chipped, or broken. An investigation by the carrier revealed that road vibration during the long trip had caused the packing material in the cartons to shift, allowing the pieces to come in contact with each other and to crack or break if the carton received any impact or rough handling.

Restaurant Supply Co. took legal action against Commercial Transport Ltd. for damages equal to the loss. Commercial Transport Ltd. denied liability for the damage to the goods.

Discuss the arguments (if any) that the parties might raise in this case. Render a decision.

Case 3

The son of elderly parents who died in an accident had his parents cremated (according to their wishes), and because he had not decided where to have their cremation urns buried, he left them with the funeral home that had conducted the funeral service and cremation.

Some time later, the funeral home contacted the son and requested instructions for the storage of the urns. Arrangements were made to have the urns placed in a crypt at a local cemetery, and the son paid for the temporary internment of the urns at the cemetery.

Some years later, the son wished to have the urns moved from the crypt for a permanent burial in a cemetery near where he then lived. The cemetery that the funeral home had sent the urns for temporary storage could find no record of receiving the urns, and the urns could not be found.

If the son instituted legal proceedings against the funeral home and the cemetery, what would be the nature of his claim? What defences might be raised by the funeral home and the cemetery? Render a decision.

Case 4

Swalm, who suffered from cystic fibrosis, contacted Dennis, who was authorized by a life insurance company to take applications for its insurance policies, and requested a life insurance policy for $200,000. Dennis provided Swalm with an application form that included a number of questions concerning the applicant's health and any existing or prior medical conditions.

Dennis reviewed the form with Swalm and his spouse, and his spouse mentioned to Dennis that Swalm suffered from cystic fibrosis but that the condition was under treatment and control by certain drugs. Dennis, acknowledged the comment but entered "none" on the form with respect to existing medical conditions for Swalm. Swalm signed the form, and the application was sent to the insurance company. A policy of insurance was then issued to Swalm.

Some months later, Swalm's cystic fibrosis could no longer be controlled by drug treatment, and a year later, he died.

Swalm's spouse, as the named beneficiary in the life insurance policy, claimed payment under the policy. When the insurance company discovered the cause of death and Swalm's medical history, it refused to pay.

If Swalm's spouse took legal action against the insurer, what would be the basis of her claim? What defences might the insurer raise? Render a decision.

Would your answer be any different if Dennis was an employee of the insurance company?

Case 5

Gourmet Food Ltd. operated a food service out of a new concrete-and-steel building that used large glass windows to provide natural lighting in the food preparation areas. Food preparation was performed on stainless steel tables, and all sinks, stoves, and food containers were metal. Perishable food ingredients and food products prepared for delivery were kept in large walk-in commercial refrigerators or freezers.

Gourmet Food Ltd. arranged with an agent for a large insurance company for insurance coverage for fire, theft, vandalism, and damage to stock. The building had an actual value of $800,000, but because of its largely fire proof construction, the agent suggested a value of $400,000. The agent also valued the contents at half their value and the usual perishable stock in a similar fashion. A policy was issued based upon the information supplied but contained an 80-percent co-insurance clause.

Some months later, late at night, vandals broke into the building, damaged the refrigeration units, emptied the freezers, and destroyed the food products. They then set fire to wooden containers and furnishings and proceeded to smash all of the windows. Before the police arrived, the vandals had vanished.

An appraiser's survey of the damage estimated the cost of repair to the building and equipment at $100,000 and the loss of stock at $10,000.

Discuss the rights of the insurance company, the agent, and Gourmet Food Ltd. Calculate the liability of the insurance company if the insurance company was prepared to pay under the terms of the policy.

Case 6

Plastic Manufacturing Ltd. produced a variety of plastic furniture in a leased building in an industrial complex. Most of the furniture that the company manufactured was either of a plastic composition or painted wood, and relatively large quantities of plastic raw materials, wood, and flammable solvents were stored on the premises.

Plastic Manufacturing Ltd. carried tenants fire insurance on its operations in the amount of $500,000 as well as business interruption insurance designed to compensate the company for any losses arising from the interruption of the business due to fire damage. The fire policy agreement restricted the storage of flammable products to a single room of the plant area and prohibited smoking in that area. Containers of flammable products in the remainder of the plant were to be kept to a minimum, and no container was to be opened in the storage area.

In accordance with the insurer's directions, employees would take the large solvent storage drums out of the storage room, open them, and fill smaller containers for distribution to the various production areas, then return the drums to the storage area.

Some time after the insurance was in place, a maintenance employee of the building owner was sent into the plant to repair a leaking water pipe near the solvent storage area. While he was making repairs to the water pipe, an employee opened the door to the storage area, removed a drum of solvent and filled several smaller containers. Just as the employee was replacing the large drum, the maintenance employee lit a propane torch to solder the water pipe. The fumes in the area immediately ignited. The resulting fire destroyed most of the manufacturing equipment, damaged the building, and seriously burned the two individuals.

Discuss the issues raised by this accident, assuming that the building owner, and Plastic Manufacturing Ltd. were insured for liability, fire, and business interruption loss. Consider also the rights (if any) of the insurers.

Case 7

While on a publisher's book tour, the author of a new novel was invited to a literary club meeting in a city that was on the author's tour route. The meeting was to be held at a hotel where the author intended to stay during her visit to the city. She accepted the invitation to read excerpts from her novel at the meeting.

The author arrived late at the hotel on the day of the meeting and, instead of registering, went directly to the meeting room for her reading. At the entrance to the room she noticed a coat room with a number of coats hanging on a coat rack. A hotel employee was standing at the door but did not offer to take her coat. She placed her coat on the rack and her suitcase on the floor under the coat rack.

After her reading, she left the meeting room to retrieve her coat and suitcase, only to find them missing. She reported her loss to the hotel desk clerk. An effort was made to find the lost coat and suitcase, without success. The author registered at the hotel, and when the coat and suitcase could not be found, demanded that the hotel compensate her for the loss of her possessions, which she valued at $3,000. The hotel offered her $40, its statutory liability for the loss of goods of a guest registered at the hotel.

The author rejected the hotel's offer of $40 and took legal action against the hotel for her loss.

What would be the basis for the author's claim? Why would the hotel not deny that she was a guest? How would the court likely decide the case?