

CONTRACT LAW

Or, what does this sheaf of papers mean?

An introduction to contract law and how it affects the insurance industry. Presented by Kathie Mautner at MARC's 2006 DI/LTC Conference.

What is a Contract?

- Unconditional
- Binding
- Promise or agreement
- Enforceable at law

In the broadest of broad terms, a contract is an agreement which the courts will enforce. It is also defined as “a promise, or set of promises, for the breach of which the law gives a remedy or the performance of which the law in some way recognizes as a duty.”

“Unconditional” in this sense, does not mean that you may not put conditions on a contract. We will discuss conditions precedent in the next few slides. When a contract is unconditional, it means that when the terms of the contract are fulfilled, the obligation to perform is enforceable.

Kinds of Contracts

- Oral or Written
- Unilateral and bilateral
- Contracts of Adhesion
- Constructive Contracts
- And then there is a “gentleman's agreement”

A unilateral contract is one where the promise is on one side and the performance on the other. For example, “I will pay you ten dollars if you will shovel the snow off my driveway”.

A bilateral contract is one where both parties exchange promises. Applying for a credit card is a kind of bilateral contract. The credit card company promises to extend credit to you, and you promise to pay the required amount upon demand. Neither promise requires immediate action, but both sides have made a legally enforceable contract.

A stub for a parking garage is a contract of adhesion – you are bound by the terms on the back of the ticket. More on that later.

Constructive contracts are contracts created by a court in equity, when it is clear that there *should* have been a contract. Say that someone does something for you that materially benefits you. Although you did not ask the person to do this, they knew that you needed it done. For example, although you may not sign a contract when you get brought into the emergency room after an accident, the courts would enforce a constructive contract to pay the charges because you expected services to be provided, and it is a service for which you would normally expect to pay.

“gentleman’s agreement” will be explained in detail under “reinsurance”

Elements of a Contract

- Offer
- Acceptance
- Consideration
- Performance
- Meeting of the Minds
- Legality
- Capacity
- Statute of Frauds

These are the elements that make a contract enforceable. We will discuss each element of the contract and its importance in the slides that follow.

OFFER

What makes an offer an Offer?

- Promise or Act
- Definite commitment
- Communicated to the offeree (person receiving the offer)
- *To do or not to do*
- Something which the recipient has no legal obligation to do
- Duration
 - Revocation
 - Death or incapacity
 - What is "a reasonable time"?

In order for an offer to be valid, there must be a promise or an act which is clearly communicated to the person receiving the offer, containing a definite commitment, to do or to refrain from doing, something which the person making the offer is not legally obligated to do. Offers can have time limits ("this offer good for 30 days" or "offer expires 8/31/04").

Death or incapacity of the offeror (or the offeree) terminates the offer.

ACCEPTANCE

What do you mean I accepted this?

- Assent
- Communication of assent
- Form of assent
 - Matching act or promise
 - Requested act or promise
- Rejection
- Counteroffer

Communication is the key to a contract.

CONSIDERATION

Pay Me!

- it must be enough
- it must be legal
- it must be unconditional
- both parties must have agreed to it

In the absence of duress, grossly uneven bargaining power or fraud, the courts will assume that the parties knew what they were doing and the value of their bargain – and leave the adequacy of the consideration alone.

PERFORMANCE

- "Show me the money!"
- Walk the walk

Once the parties agree to the consideration, the contract is not completed until the performance of the consideration – handing over the money, dancing around the bonfire at midnight, stopping smoking.

Conditions precedent are certain conditions that must be fulfilled before performance is complete. For example, if the contract requires that “no insurance exists until all medical examinations and laboratory tests have been completed and evaluated by our underwriters”, then that means that no coverage would exist until those conditions have been fulfilled – conditions that must *precede* (hence the term “condition precedent” performance in order for the contract to be enforceable.

MEETING OF THE MINDS

- The parties have to mean the same thing when they agree to contract
- "I didn't know it was loaded!" (contract of adhesion)
- "These are not the droids you're looking for." (ambiguous terms)
- "Huh?" (comprehension)

In order to have an enforceable contract, both parties have to agree to the same contract. If one or the other person does not agree (we'll discuss this further under "Capacity") then there is no contract. We also discuss "errors and omissions", contract interpretation and ambiguous terms such as "issue".

LEGALITY

- Drug deals and other nefarious schemes (I'll make you an offer you can't refuse!")
- Gambling (so-called aleatory contracts) and other wagering
- State, local and federal regulations

Insurable interest laws arose because of the public policy against wagering on a human life. Viatical contracts figure here.

CAPACITY

- Minors
- Duress
- Undue influence
- Language barriers
- Mental incapacity
 - Handicap
 - intoxication
- Illiteracy is NOT necessarily a defense to capacity

Just because a person is illiterate does not mean they cannot make a valid contract. A contracting party must make sure that the illiterate person understands what is being asked, and there must be objective evidence that the person understood the nature of the contract.

THE STATUTE OF FRAUDS

- Certain contracts must be **written** in order to be enforceable
 - Executor's promise to pay a claim against the estate from own funds
 - Promise to be legally responsible for the debt of another
 - Promise made in consideration of marriage
 - Agreement to sell, or a sale of, any interest in real property
- **IMPORTANT LAST ONE!**
 - An agreement that cannot be performed within one year of the time of making the agreement

“within one year” is usually about six weeks of the law school class, and the statute of frauds usually covers one semester, but here it is in five minutes!

CONTRACT CONSTRUCTION

- Clear and unambiguous language
- Ordinary meaning of words unless defined
- Construed as a whole ("four corners")
- Unclear language goes **AGAINST** the drafter of the contract (unlike at casinos, ties do NOT pay the dealer)

A contract must be understandable and clear. A dispute over terms, when the language is ambiguous, goes to the party which did not draft the contract.

Defenses

- Material misrepresentations
- Terms of the contract
- Failure to act in accordance with terms of the contract
- Intent
- Estoppel

Terms – “we will reinsure your DI-99 policy forms for those issued after 1/1/06”.

Failure: “according to your normal underwriting guidelines”

Rescission – there is no contract

Unclean hands – we messed up too

Estoppel – legal term which means that you are legally barred from raising this defense

Material misrepresentations – there is no contract because there never was meeting of the minds (the applicant concealed something)

WHAT THIS MEANS TO A REINSURER

- **A Gentleman's Agreement** - why we call them "treaties" and not "contracts"
 - When is a party not a party? or the difference between the insured, the ceding company and the assuming company
- Amendment or novation?
- Continuity (what happens if company A buys company B and transfers the block of business for which we have an obligation to company C?)

When reinsurance began, business was customarily done on a hand-shake, insurance professional to insurance professional. It was a relationship of mutual trust. As companies become larger, multinational, impersonal and acquisitorial, the smaller companies' traditions, understandings and personal relationships between client and reinsurer erode, and history is lost as personnel changes occur. For the protection of all parties, and to conform with regulatory requirements, agreements now tend to be contained in written form.