

BASICS OF THIRD PARTY COVERAGE

4

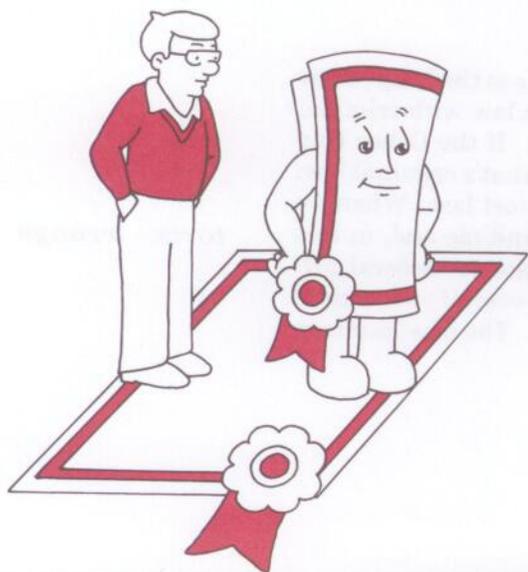
- 1 The purpose of all liability policies is to **protect your assets if you injure someone else or their property and are legally obligated to pay for the damage.**

- 2 In many respects, this is the opposite viewpoint most people hold as a reason to buy insurance. Most folks buy insurance to protect their property: their building, their business property, their inventory, etc. They are concerned that their *stuff* will be attacked by some peril. Addressing that concern is the function of property insurance as we have studied it. **However, liability is different.** In liability, the risk arises from your property – your building, your inventory, your business activities, etc., and it is the other person who is injured. For example, suppose that the sign over Joe's restaurant falls on a passer-by. In the absence of liability insurance, he would sue Joe for the damages. Liability insurance simply pays on Joe's behalf the damages he is legally obligated to pay.



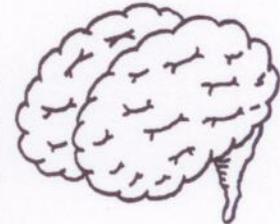
*The Insurance
world turned
upside
down*

3rd Party



1 Notice that a liability policy is not designed to pay you. It does not protect your body or your property. Instead, it **pays to a third party** for damage to his body or property for which you are legally responsible. So, here's your first big legal term: we'll refer to this third party as *the Other Guy*. There are some additional terms which define the damage you might do to the Other Guy.

- **BODILY INJURY (BI)** – the physical destruction or injury of a human being.
- **PROPERTY DAMAGE (PD)** – the physical destruction or damage to *stuff*, which is anything tangible other than human beings. If you hit a cow on the highway, that is property damage.
- **PERSONAL INJURY** – Despite what the name implies, Personal Injury has nothing to do with injury to a person's body (Bodily Injury). Instead, Personal Injury concerns **injury to a person's reputation or mental state**. Personal Injuries include false arrest, false imprisonment, false search and seizure, malicious prosecution, libel, slander, defamation of character, violation of civil rights or right of privacy, wrongful entry or eviction or the invasion of the right of private occupancy. As you can see from the list, not one of the above listed items includes bodily injury but simply relates to mental, reputation or psychological damages to the "injured" person. Please keep in mind the distinction between *Personal Injury* and *Bodily Injury*.
- **ADVERTISING INJURY** - Like personal injury but the victim is a business and not a person.



*it's all in your
mind*

*copyright,
trademark, etc.*

2 Notice that we have used the terms legally obligated to pay or legally responsible several times already. It is important to gain an understanding of these phrases.

LEGALLY OBLIGATED TO PAY

3 There are two ways in which you can become legally obligated to pay:

- Settlement – Out of court
- Judgment – In court

4 In either event, the dispute will be resolved under **tort** law. This is the body of law that governs *wrongs between individuals*. We can contrast tort law with criminal law, which governs wrongs between an individual and society. If the Other Guy walks into your store and you shoot him for not buying enough, that's criminal law. If he slips and breaks his leg on your newly waxed floor, that's tort law. When we say wrongs between individuals, we include persons like you and me and, in this context, we also include companies, associations and even the state and federal government. Any of these entities can be sued as individuals. However, if you want to sue the federal government, you must first obtain its permission. The most common tort, negligence, is the primary concern of liability insurance.

torts – wrongs

NEGLIGENCE

1 In a layperson's terms, negligence can be expressed fairly simply. "I was injured because you did not act responsibly." The problem is that several of us could view the same act and disagree vehemently about how responsible or irresponsible it was. Our viewpoint is colored by our own experience and beliefs. If you and I both saw a car drive down the street, we might describe it very differently. You might say the car is big because you drive a Geo. I might say it's small because I drive a Lincoln. I might describe the car that went past us as new and light colored because mine is very old and black. You might see it very differently if yours is brand new and white. Since the law needs to speak with a single viewpoint, tort law has created the concept of the *Reasonable Person* in the form of the men and women that make up a jury. Therefore, we can define negligence a little more precisely. **Negligence is the failure to do or not do what the Reasonable Person would do or not do under the same or similar circumstances.** Under normal circumstances, when a reasonable person is driving his car and encounters a stop sign, he stops. If under the same circumstances, you run the stop sign and injure me, you are negligent.

if you're reasonable, you can never be negligent

2 Now, it's not really that simple nor that cut and dried. Shortly, we will look at four separate elements that must be established to demonstrate negligence. But before we do, let's observe that **negligence is never an intentional act.** If you draw back your fist and punch me in the nose, that is not negligence. Negligence may be an act of carelessness, ignorance, thoughtlessness, inaction . . . but it is never an intentional act.

omissions... yes
commissions... yes
intentional acts... no

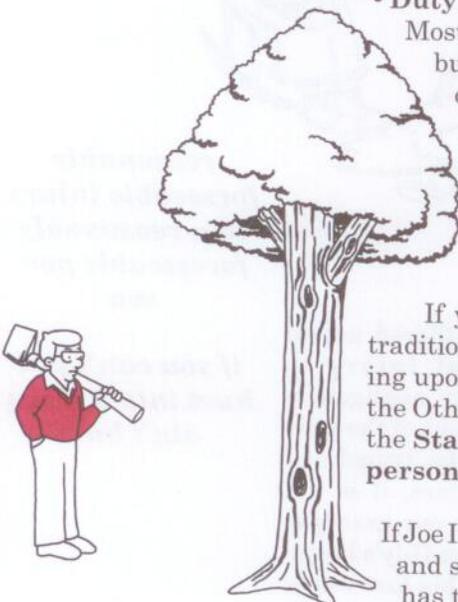
Establishing Negligence

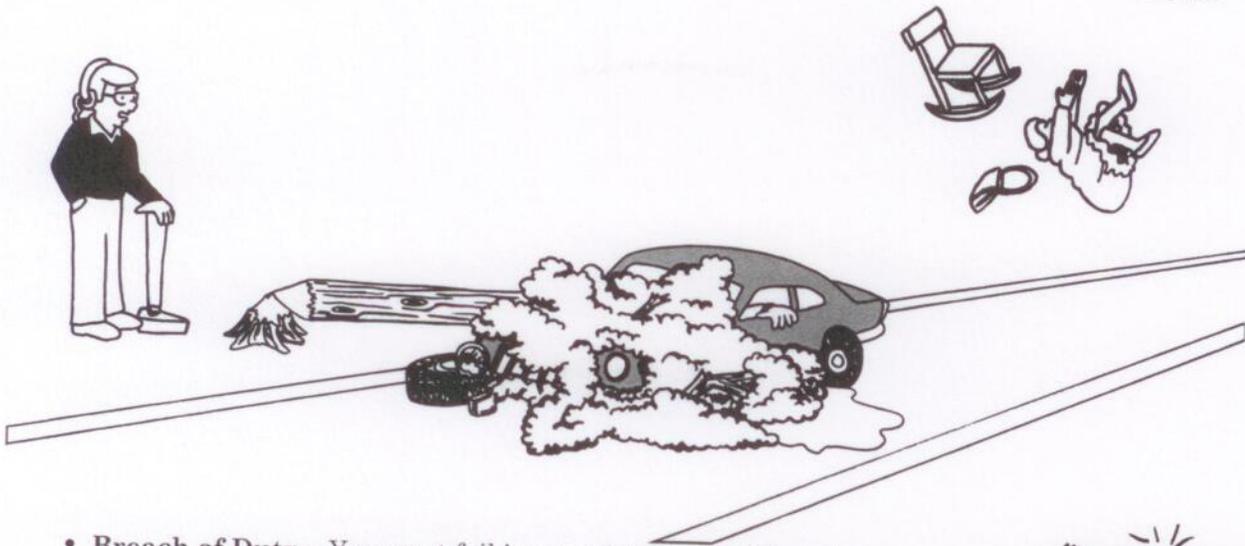
3 To establish negligence, the injured party must prove four specific elements of negligence. Like a four-legged table, negligence will not stand on three legs, two legs or one leg. All four elements must be established or there is no negligence.

4 • **Duty** – You must have a *duty* to the injured party. Most of the duties we have as individuals or as businesses are not duties we have signed up for or agreed to specifically. Most of our duties simply balance the privileges we enjoy in free society. For example, if you enjoy the privilege of operating a motor vehicle, you have a duty to stop when you encounter a stop sign.

5 If you ever go to law school, you will find that traditionally, there are varying degrees of *duty* depending upon the relationship you have or do not have to the Other Guy. But for our purposes, we can say that the **Standard of Care** is to **act as the reasonable person would act.**

6 If Joe Insured is a homeowner, he has many privileges and some corresponding duties. For instance, Joe has the right to chop down the 80-foot oak tree in his front lawn. But since the tree is only 40 feet from the street, Joe has a duty to see that when the tree falls, it does not injure a passer-by.





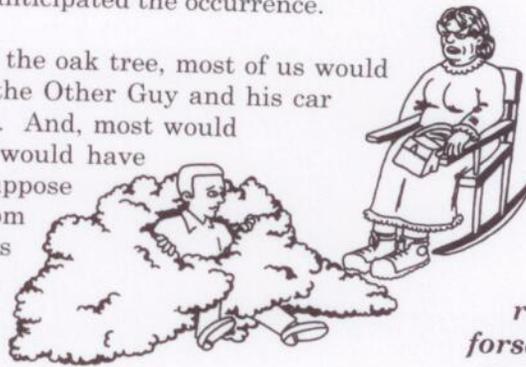
- **Breach of Duty** – You must fail in your duty to the Other Guy.

To continue the example, if Joe's tree fell on the Other Guy who was driving down the street, Joe would have failed in his duty to use reasonable care.



- **Proximate Cause** – Your breach of duty must be the proximate cause of the Other Guy's injury or property damage. This actually means two things. Your action must be (1) the **direct** and (2) the **foreseeable** cause of the Other Guy's loss. Direct means that there must be an unbroken chain of events from your action to the Other Guy's injuries. Foreseeable means that a reasonable person would have anticipated the occurrence.

In our example with Joe Insured and the oak tree, most of us would agree that the injuries sustained by the Other Guy and his car were the **direct** result of Joe's action. And, most would also agree that a reasonable person would have anticipated the outcome. However, suppose Aunt Harriet watches this event from her porch two blocks away and suffers a heart attack due to the excitement. That string of events would probably not be foreseeable to most folks, so Aunt Harriet's death could not, therefore, be directly attributed to Joe's negligence.



reasonably foreseeable injury to a reasonably foreseeable person

- **Damages** – The Other Guy or his property must have suffered actual

financial injury to establish negligence. Simply put, if the hurt cannot be translated into dollars, it is not hurt. In our example, the Other Guy's hospital bill, his lost wages and the repair bill for his automobile would be considered damages.

if you can't put hurt into \$... you ain't hurt



Types of Damages

1 **Compensatory Damages** are those which are designed to, as far as possible, restore the Other Guys to their pre-injury status. There are two types of Compensatory Damages:

- **Special or Economic Damages** are those which are readily identifiable... such as medical bills, lost wages, dented fenders.
- **General or Noneconomic Damages** are those which don't come with a receipt...pain, suffering, loss of enjoyment, embarrassment.

2 **Punitive Damages**, unlike Compensatory Damages, are not designed to make the Other Guy whole. Their purpose is to punish the wrongdoer. The theory is that such punishment will deter the defendant or similar actors from doing the same type of bad act in the future.

Legal Defenses

3 If the Other Guy alleges that Joe was negligent, there are several potential defenses available to Joe. Only the first fits the oak tree example that we have been developing.

4 **Comparative Fault** – If the Other Guy is even partially responsible for his own injuries, then Joe's financial obligation would be reduced accordingly.

balance the blame

5 If, for instance, Joe could establish that the Other Guy was talking on his cellular phone when the accident happened, maybe the jury would attribute 20% of the fault to the Other Guy and subsequently reduce the award by 20%.

6 **Assumption of Risk** – If the injured person knowingly placed himself in a dangerous position, it might eliminate the possibility of negligence on someone else's part.

7 A driver in the Indy 500, for example, would probably not be able to establish negligence on the part of a fellow participant. The Reasonable Man would say that an individual who gets into a bathtub of gasoline and drives it at 240 m.p.h. around a bull ring with thirty-two other drivers assumes his own risk of injury.

8 **Contributory Negligence** - Comparative fault is **not** the same as contributory negligence. Under contributory negligence the Other Guy collects nothing if **any of the fault** is his own. Not an available defense in most jurisdictions.

9 **Intervening Cause** - Usually there must be a direct relationship between the negligent act and the Other Guy's injuries. If some other factor or force acted to either cause or enhance the damages, then the defendant could be released from liability. This, however, would not occur if the intervening force was reasonably foreseeable. Example: Joe negligently left a broken glass on the floor of his restaurant. Bob trips and knocks Betty down and she is cut by the broken glass. Most courts would still hold Joe liable because actions such as Bob's are reasonably foreseeable.

10 **Statute of Limitations** - Legislatures set the time limits in which the injured party may sue the defendant. After the time runs out, the injured party has no right to pursue a legal action.



- 1 These limitations vary not only from state to state but also among the different legal theories of recovery. Example: a state may have a two year negligence statute of limitations and a ten year one for products liability actions. The purpose of the statute of limitations is to ensure that the defendant can reasonably prepare a defense. It would not be fair for the Other Guy to sue Joe on his fiftieth birthday for a bicycle accident that took place on the playground in the fourth grade.

OUTSIDE THE NEGLIGENCE BOX

- 2 To this point, we have examined the tort of negligence, truly the *pop tort* of liability insurance. Simply put, if you injure the Other Guy and the four elements of negligence can be established, you are liable. It is possible, however, for you to be liable even for things you did not do or for occurrences in which the elements of negligence cannot be established.

Strict Liability

- 3 Strict Liability is the standard by which products liability cases are measured. Unlike negligence, **duty is not a factor**. In products liability, you are responsible if you manufacture, distribute or sell a product which injures people or damages their property.

Absolute Liability

- 4 In absolute liability cases, **neither duty nor breach of duty are factors**. The defendant can be held liable for damages simply because an injury has occurred. Traditionally, the law has limited absolute liability actions to injuries that have been caused by the defendant's animals or livestock, or in cases where the defendant has been involved in an abnormally dangerous activity, such as using explosives. Many of the pollution liability statutes enacted over the past decade have also been based upon absolute liability theories. Example: Bad goo enters the ground water at Joe's business, don't care how, don't care when, don't care why, don't even care if Joe knew about it; Joe's responsible for the clean up.

*Explosives...
...wild animals...
...pollution*

Vicarious Liability

- 5 When one person does something for the benefit of another, liability is often reaped along with the benefits. For instance, if Joe's secretary, Betty, were driving to the post office for Joe, and she causes an accident, even if she were driving her own car, Joe would be vicariously liable for Betty's acts. This is an example of the most common form of vicarious liability, the Master-Servant rule. . . an employer is responsible for the negligence of his employees during the course of their employment. Vicarious liability can also apply to parents for actions of their children or to employers for acts of independent contractors.

"NO FAULT" BENEFITS

- 6 Though most casualty contract benefits are available if and only if you are held to be legally liable, there are two huge benefits that are payable without regard to fault.

Medical Payments

- 1 The Medical Payments section is unusual in that it is the only section of the policy that can pay benefits directly to the **Other Guy** (or his doctor) without establishing a legal obligation to pay.

medical bills only

- 2 **The Medical Payments section of the policy pays without regard to fault.** If the Other Guy slips and falls on Joe's driveway, Medical Payments (Med Pay) pays. Even if the Other Guy is on roller skates and it appears that he himself is to blame, Med Pay still pays. The limits are rather low (beginning at \$1000 per person), but it would certainly pay enough to set the Other Guy's broken arm. Personal Lines contracts will provide Med Pay benefits for up to **three years** from the date of the accident, but Commercial Lines policies limit this benefit to **one year** from the date of the accident.

no fault

- 3 Obviously, the intent of Medical Payments is to avoid lawsuits. It's like goodwill insurance. If Joe can pay to fix the Other Guy's arm with no hassle, maybe there will be no lawsuit. However, this benefit is limited to bodily injury. Med Pay can pay the doctor, the dentist or even the funeral home, but there is no benefit for lost wages or pain and suffering.

Supplementary Payments

- 4 Though the word supplementary sounds like an optional add-on, **all liability policies have Supplementary Payments.** They come with the policy—you cannot buy the policy without this benefit.

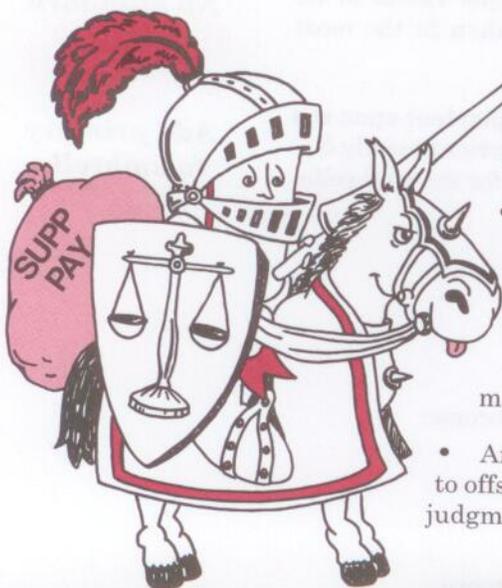
- 5 While there are a half a dozen benefits which make up the category of Supplementary Payments, the biggie is **Defense Costs.** For any claim or lawsuit filed against you (to which the insurance applies), the insurance company will provide your legal defense. These costs are paid **in addition to** the limits of liability in most contracts.

expenses for defenses

- 6 Though it is certainly important that the insurance company provide you with a legal defense in situations where you may be held legally responsible, it may be even more important that a defense be provided if the Other Guy's claim is groundless. Nuisance suits are becoming more common, and it may cost up to \$150 - \$500 an hour to establish that you are not liable.

in addition to the face amount

- 7 Other benefits provided by Supplementary Payments include:



- All other expenses incurred in investigating or settling the claim.
- Reasonable expenses you incur at the company's request in assisting their defense efforts, including loss of earnings up to a daily limit.
- The cost of appeal bonds and attachment bonds.
- Any interest awards made to the Other Guy to offset the time between the occurrence or the judgment and the actual payment of damages.

OTHER LIABILITY POLICIES

COMMERCIAL AND PERSONAL UMBRELLA POLICIES

1 As the size of liability awards given by juries increased to the astronomical, many businesses and some individuals began to want extremely high limits in the liability coverages. To take a basic liability policy and extend it to \$1 million, \$5 million or more would be prohibitively expensive. The companies would be taking care of all the small claims and would still be responsible for the occasional huge claim. Lloyd's and others stepped in and designed the Umbrella Policy. An Umbrella is designed to augment the limits of primary liability insurance policies.

2 The concept is really quite simple. Suppose you own an Auto policy with limits of \$500,000 per person **plus** a \$1 million Personal Umbrella. You hit a pedestrian with your car and he is paralyzed for life. The jury awards \$1 million. Your Auto policy will pay \$500,000 and the Umbrella will pay the \$500,000 excess.

3 Surprisingly enough, Umbrella policies are relatively inexpensive. This is because most claims are still small claims. The Umbrella policy gets hit hard when it does get hit, but most claims are adequately covered by the basic policies.

4 **There are really only four basic things to remember about Personal or Commercial Umbrellas:**

- **Excess amounts**
- **No standard form**
- **Uneven at the top**
- **Broadens as well as deepens**

Let's address each in turn.

5 **Excess Amounts** – Umbrellas are written for excessive amounts – \$1 million, \$5 million, \$10 million and more.

Big Bucks

6 **No Accepted Standard Form** – Though Umbrella coverage is readily available today, almost every company writing Umbrellas has a few unique twists in its contracts. Therefore, everything in this discussion should be taken in the most general of terms.

No Standard

7 **Uneven At The Top** – Since the rating of Umbrella policies is dependent upon the underlying coverages absorbing most of the losses, the Umbrella carrier literally dictates which basic coverages you must have if you are to be eligible for the Umbrella.

Add primary to umbrella

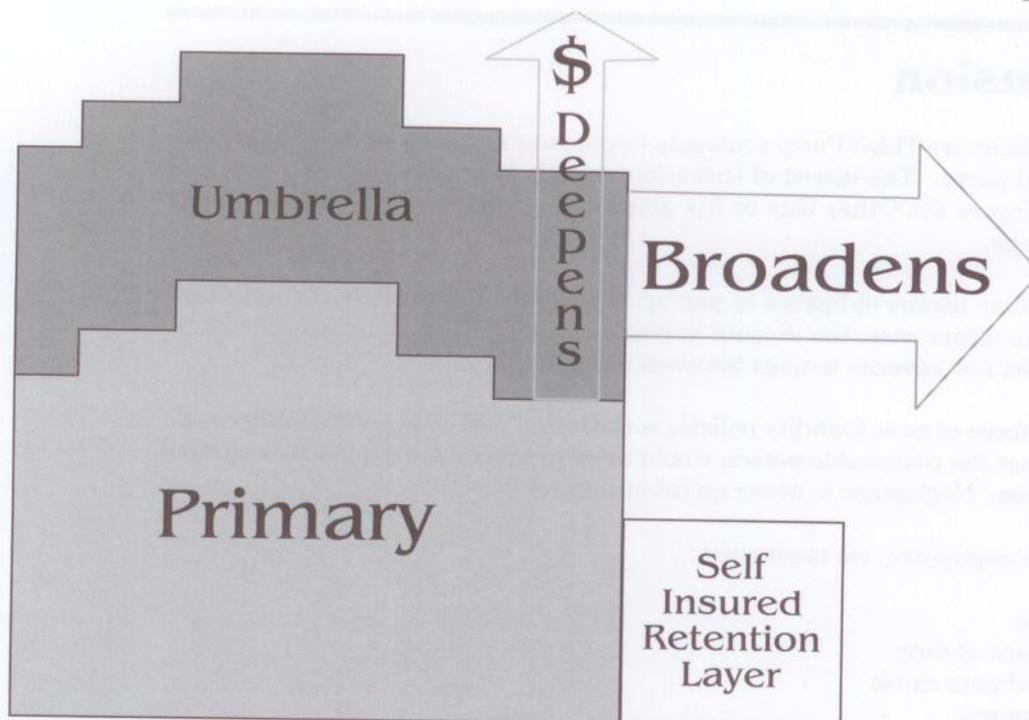
8 Joe might have the following Liability coverages:

- | | |
|--------------|----------------------|
| • Homeowners | \$100,000/occurrence |
| • Auto | \$500,000/person |
| • Boatowners | \$100,000/occurrence |

9 If he also owns a \$1 million Personal Umbrella, then his limits become:

- | | |
|--------------|-------------|
| • Homeowners | \$1,100,000 |
| • Auto | \$1,500,000 |
| • Boatowners | \$1,100,000 |

10 Coverage is **uneven at the top** because it is **uneven at the bottom**.



- 1 **Broadens As Well As Deepens** – Without this final characteristic, there are actually two products that would do everything discussed so far:

- Excess Liability policy
- Umbrella liability policy

- 2 The difference between these two contracts is that the **Excess Liability policy will never pay unless the underlying policy pays first.**

Suppose that Joe is driving an auto in Germany when he causes a \$1 million wreck. His Auto policy defines the coverage territory in the U.S., Canada and Puerto Rico. His Auto policy will not pay and, therefore, an Excess Liability policy will not pay. The Personal Umbrella would, however, **broaden** to cover this loss. Joe would be responsible for first paying a **Self Insured Retention** of, say, \$25,000, which functions like a large deductible.

THE CASUALTY ODDBALL

Fire Legal Liability

- 3 Liability contracts typically exclude coverage for property in your care, custody or control. This is logical because most stuff that is in your care, custody or control is yours – therefore insured under a Property contract, not a Liability contract.

- 4 But, what about space in a building you rent (and occupy) and accidentally set afire? You probably could not buy property coverage because you don't own the building. If the aforementioned liability exclusion applies, you would have no coverage on the liability side either. Fire Legal Liability provides coverage for tenants who negligently damage the space they occupy in the landlord's building. This is damage done to the **building** - contents are covered under the tenant's property coverage. This coverage is available in both Personal Lines (Homeowners) and Commercial Lines (Commercial General Liability).

Conclusion

Liability policies are Third Party contracts – you, your company and the unknown, injured third party. The intent of these contracts is to protect your assets if you negligently injure the Other Guy or his property and are legally obligated to pay for the damage.

You can become legally obligated to pay by settlement (out of court), or judgment (in court). In either case, the dispute is resolved under the body of law known as tort law – tort law governs wrongs between individuals.

The central focus of most Liability policies is the tort of negligence – the failure to do or not do what the reasonable person would do or not do under the same or similar circumstances. Negligence is never an intentional act.

To establish negligence, we must show:

- Duty
- Breach of duty
- Proximate cause
- Damages

Compensatory damages are intended to restore the Other Guy to his pre-injury status. Punitive damages are intended to punish the wrongdoer.

If negligence is alleged, the defendant might utilize any of several legal defenses:

- **Comparative fault** – some fault was that of the injured party
- **Assumption of risk** – the Other Guy knowingly placed himself in a dangerous position
- **Contributory negligence** – any fault was that of the injured party
- **Intervening cause** – some other factor acted to cause or enhance the damages
- **Statute of limitations** – too much time has passed

Liability policies contain two important benefits that have nothing to do with fault:

- **Med Pay** benefits can fix the Other Guy's body to avoid a lawsuit
- **Supp Payments** are paid in addition to the policy limits. The most important Supp Payment is the cost of defense.

Personal and Commercial Liability Umbrellas are additional liability benefits that are available after the benefits of the underlying policies have been exhausted. Umbrella characteristics include:

- Written in excessive amounts
- No standard form
- Uneven at the top
- Broadens as well as deepens

Fire Legal Liability provides coverage for tenants who negligently damage the space they occupy in the landlord's building.