Casualty (Liability) Basics

OVERVIEW

This chapter represents the foundation of liability insurance and discusses the various terms, definitions, principles, and concepts used in liability policies. A liability policy provides protection for legal liability arising from unintentional torts for bodily injury or property damage to others. Liability insurance is also referred to as third-party insurance because loss payments benefit someone other than the insured. The insured is the first party to an insurance contract, the insurer is the second party, and an unknown party (the claimant) that suffers harm is the third party.

Upon the completion of this chapter, you will be able to:

■ Define basic casualty or liability insurance terms
■ Recognize the liability insurance principles and concepts of negligence
■ Recall the component parts of a liability policy
■ Identify the common liability policy provisions
■ Define the terms used to express limits of liability

3.1 Liability Insurance Terminology

Liability insurance only provides coverage when the insured is legally liable for causing injuries or damage. Legal liability is the responsibility under law or contract for an act or failure to act.

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tbody>
<tr>
<td>Tort</td>
<td>A tort is a wrongful act, other than a breach of contract, that violates a duty or the rights of another and for which compensation may be sought from the responsible party. Torts are either intentional, or unintentional. An intentional tort is a deliberate act that harms another and for which the injured party is permitted by law to sue the wrongdoer. An unintentional tort, also known as negligence, is an act, or failure to act that is committed without the same level of care a reasonable individual would have exhibited given the same knowledge and set of circumstances. Liability insurance provides coverage for most unintentional torts and excludes intentional torts.</td>
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<tr>
<td>Vicarious Liability</td>
<td>The liability assigned to one party for the conduct of another, based solely on a relationship between the two. Examples include employer/employee relationships and parent/child relationships.</td>
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<tr>
<td>Negligence</td>
<td>Failure to use ordinary care or act in a reasonable or prudent manner. For example, running a red light.</td>
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<tr>
<td>Gross Negligence</td>
<td>Failure to exhibit any sort of care through recklessness or deliberate indifference to the well-being of others. For example, driving while under the influence of alcohol.</td>
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<td>Loss of Consortium</td>
<td>The loss of companionship of a spouse or family member due to a tort.</td>
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<td><strong>Compensatory Damages</strong></td>
<td>Awarded to the injured party for the actual loss sustained. Damages are Special or General. <strong>Special damages</strong> are an award to an injured party for actual and known expenses such as bills, loss of earnings, and the costs of repairing or replacing damaged property. Special damages are paid for tangible loss or damage. <strong>General Damages</strong> are an award to an injured party for pain, suffering, mental anguish, disfigurement, and similar types of losses. General damages are paid for losses that cannot be calculated objectively and assigned a specific dollar value. Exemplary Damages may be awarded in cases of breach of contract where malice, oppression, or fraud was the basis for contract formation.</td>
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<td><strong>Punitive Damages</strong></td>
<td>An award to an injured party, in addition to compensatory damages, to punish and discourage a wrongdoer from repeating negligent acts or omissions, as in the case of gross negligence.</td>
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<tr>
<td><strong>Bodily Injury Liability</strong></td>
<td>Legal liability arising from physical injury, including sickness, disease, and death caused by the acts or omissions of an insured. Bodily injury liability damages include medical bills, lost wages, mental anguish, or disfigurement.</td>
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<td><strong>Property Damage Liability</strong></td>
<td>Legal liability arising from physical damage to tangible property, including loss of use of that property, caused by the acts of an insured. Property damage liability includes the actual cost of repair or replacement of the damaged property as well as the inability to use damaged property (loss of use).</td>
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<td><strong>Medical Payments Coverage</strong></td>
<td>Coverage for the bodily injury of third parties sustained on an insured location or as a result of the insured’s activities. Coverage is provided for the payment of necessary medical, surgical, x-ray, dental, ambulance, hospital, professional nursing, and funeral expenses. Payments are made regardless of the insured’s negligence. Payments are not an admission of guilt.</td>
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<td><strong>Personal and Advertising Injury Liability</strong></td>
<td>Legal liability arising from specific offenses committed by an insured that results in injury other than bodily injury or property damage. Examples of personal injury include libel, a written statement, and slander, an oral statement, that unjustly damage another’s reputation. Examples of advertising injury include misappropriation of advertising ideas and copyright infringement.</td>
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<td><strong>Accident</strong></td>
<td>A sudden, unforeseen, unintended, and unplanned event from which loss or damage results.</td>
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<td><strong>Occurrence</strong></td>
<td>An incident that results in a loss or a series of losses; multiple occurrences result in multiple deductibles that seem to be part of a single event, but are actually separate events.</td>
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<td><strong>Notice of Loss</strong></td>
<td>Insured must notify the insurer in writing as soon as possible in the event of any loss or occurrence. The written notice should include the named insured, policy number, and details about the time, place, circumstances of the occurrence, and names and addresses of any claimants and witnesses.</td>
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<td><strong>Proof of Loss</strong></td>
<td>A formal statement made by the insured and provided to the insurer that provides necessary details for the insurer to determine its liability under a policy.</td>
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<td><strong>Certificate of Insurance</strong></td>
<td>A document that shows evidence that specific types of insurance were purchased by the insured, at certain limits, and that they were in place on the date the certificate of insurance was issued. A certificate of insurance is not proof of insurance, as a binder is.</td>
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<td><strong>ACORD (Association for Cooperative Operations Research and Development)</strong></td>
<td>ACORD develops a number of industry standards for data acquisition and use. These standards have been adopted by hundreds of insurance companies all around the world. A large part of ACORD’s work is in the development and distribution of various, reusable insurance industry documents. Materials range from Certificates of Insurance to documents for specific state.</td>
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Retention Question 1

_A(n) ____________ is a civil wrong committed by one person against another._

a. Tort  
b. Accident  
c. Breach  
d. Punitive damage

Retention Question 2

*Which of the following damages is awarded to the injured party for the actual medical expenses incurred?*

a. General  
b. Punitive  
c. Special  
d. Consortium

Retention Question 3

*Which of the following document reports how and when a loss happened?*

a. Certificate of insurance  
b. Notice of loss  
c. Proof of loss  
d. Occurrence report

Retention Question 4

*Payment of necessary medical expenses without regard to negligence is covered by which of the following insurance coverages?*

a. Medical Payments  
b. Bodily Injury  
c. Property Damage  
d. Personal Injury Liability

### 3.2 Liability Insurance Principles and Concepts

#### Negligence

An unintentional tort (civil or private wrong) defined as the failure to act in a reasonable and prudent manner usually incurring a monetary penalty. The fact that there was an accident does not itself establish a presumption of negligence. The person claiming damages usually must prove that the actions of another were the direct or proximate cause of the injury or damages.

**Elements of negligence** – In order for an act (or failure to act) to be considered negligent, it must contain 4 elements:

1. **Legal Duty (Duty)** – The obligation to conform to a certain standard of conduct for the protection of others. When the insured and a third party cannot agree on legal liability, the courts make the final decision.

2. **Standard of Care (Breach)** – The degree of care that a reasonably prudent person should exercise in the same or similar circumstances.
3. **Proximate Cause (Unbroken chain)** – A natural and continuous sequence, unbroken by any efficient intervening cause, that produces injury and without which the result would not have occurred.

4. **Actual Loss or Damage (Injury)** – Loss or damage resulting from the real and substantial destruction of property of another or physical injury to another.

   **Take Note**
   
   *If any of the four elements is absent, an act, or the failure to act, is not considered negligent.*

### Defenses Against Negligence

When a claimant accuses an insured of negligence, the insured may use one of several defenses:

#### Common Law Defenses (based on judicial or court decisions)

- **Contributory Negligence** – Prevents recovery for damages caused by a negligent party if the claimant was negligent to any extent. For example, if the claimant is 5% negligent and the wrongdoer is 95% negligent, the claimant is not permitted to collect damages.

- **Assumption of Risk** – Prevents recovery if the claimant knowingly assumed the risk.

- **Intervening Cause** – Prevents recovery from the negligent party when a separate negligent act occurs and interferes with the chain of events (proximate cause) that brings about the loss.

#### Statutory Law Defenses (based on legislation)

- **Comparative Negligence** – Damages are reduced in proportion to the degree of the claimant’s negligence. For example, if the claimant is 5% negligent and the wrongdoer is 95% negligent, the claimant may only recover 95% of damages. California allows for “Pure Comparative Fault.” This rule allows a damaged party to recover even if it is 99% at fault, although recovery is reduced by the damaged party degree of fault.

- **Statute of Limitations** – The length of time during which a person may file a lawsuit.

#### Example

*If an injured party were determined to be 20% responsible for their injury, no damages would be awarded under the doctrine of contributory negligence. Under the doctrine of comparative negligence, the damage award would be reduced by 20%. Contributory negligence absolves the damages completely while comparative negligence reduces the amount of the damages proportional to the injured party’s negligence.*

### Strict Liability

Strict liability is a legal principle that imposes legal liability based on conditions, activities, or products that are highly hazardous. The liability exists without regard to fault or negligence.

- **Strict Liability** is most often associated with dangerous animal ownership, storage of firearms or weapons, and possession of explosive or highly flammable material. Absolute liability is responsibility without regard to fault or negligence. For example, the keeping of dangerous animals, such as a poisonous snake, automatically imposes a liability even if reasonable care is taken to protect from a loss.

- **Strict Product Liability** provides that a manufacturer or seller of a product is liable for all damages caused by a defective product without regard to fault or negligence.
Property Owner’s Obligation

The 3 general classes of persons that a property owner may have an obligation to protect are:

1. **Invitee** – When a person is invited onto the property, the property owner must warn him/her of any hidden dangers.

2. **Licensee** – A person on the premises with the owner’s knowledge and tolerance, but possibly without benefit. A property owner has a lesser duty than to an invitee.

3. **Trespasser** – A person on the premises without the owner’s permission. It is not necessary to warn of hidden dangers.

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Retention Question 5

*Each of the following is an element of negligence, except:*

- a. Duty
- b. Breach
- c. Injury
- d. Intervening Cause

Retention Question 6

*Which of the following is a common law defense used by the negligent party when the injured party is partially responsible for his own injuries?*

- a. Proximate cause
- b. Contributory negligence
- c. Absolute liability
- d. Comparative negligence

Retention Question 7

*Which of the following provides that a manufacturer of a product is liable for all damages caused by a defective product without regard to fault?*

- a. Strict product liability
- b. Comparative negligence
- c. Proximate cause
- d. Vicarious liability

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### 3.3 Common Policy Provisions

**Insureds**

- **Named Insured** – The person or organization designated on the Declarations page of the policy as being protected by an insurance contract.

- **First Named Insured** – The name of the person or organization that appears first on the Declarations page of a policy as “named insured.”

- **Additional Insured(s)** – Other persons, companies, or organizations not ordinarily protected by a policy but are granted status as an insured.
Other Insurance
This provision specifies the process to be followed when more than one policy covers the same loss.

■ **Primary** – If the policy is primary, it makes payment before all other policies in place make payment for a loss.

■ **Excess** – If the policy is excess, it makes payment only after all other insurance in place exhausts its limits or denies coverage.

■ **Pro Rata Liability** – To prevent an insured from collecting more than the actual extent of the loss, each policy pays no more than its share of the loss (pro rata share) in proportion to the coverage of that policy with respect to the total of all insurance on the risk. This reinforces the principle of indemnity.

■ **Contribution by Equal Shares** – Each insurer contributes an equal amount until the loss is paid or each insurer has paid its limit of insurance, whichever occurs first.

■ **Nonconcurrency** – A condition created by two or more liability policies covering the same loss exposure that do not have identical inception and expiration dates. This creates a gap in coverage.

Limit of Liability/Limits of Insurance
Each policy includes a provision that specifies the most it will pay in the event of loss. Certain limits of liability apply to any one loss; other limits apply to the total of all losses that occur within the policy period.

■ **Per Occurrence Limit** – The most the policy will pay for all losses arising out of any one occurrence, regardless of other policy limits.

  **Example:**
  
  *The limit of liability for personal liability on a homeowners policy is a per occurrence limit.*

■ **Per Person Limit** – The most the policy will pay for loss to any one person injured in any one loss, regardless of other policy limits.

  **Example:**
  
  *The bodily injury limit of liability on an auto policy is a per person limit.*

■ **Aggregate Limit** – The most the policy will pay for all losses submitted during the policy period, regardless of other policy limits. Each loss payment made under a per occurrence limit or per person limit reduces the aggregate limit of liability.

■ **Split Limits** – The most the policy will pay for loss of different types that occur as a result of any one loss, regardless of other limits.

  **Example:**
  
  *The limits of liability on an auto policy for bodily injury might be represented as 100/300/100 ($100,000 is the per person limit for bodily injury liability, $300,000 is the per occurrence limit for bodily injury, and $100,000 is the per occurrence limit for property damage liability).*

■ **Combined Single Limit** – The most the policy will pay for all losses of all types resulting from any one occurrence, regardless of other limits.

  **Example:**
  
  *The per occurrence limits on homeowners and general liability policies provide coverage for the sum of all bodily injury liability and property damage liability claims that arise from one occurrence.*
Retention Question 8

Which of the following is designed to prevent the insured from collecting more than the actual extent of a loss?

a. Excess insurance  
b. Primary coverage  
c. Pro rata liability  
d. Contribution by equal shares

Retention Question 9

The ______________________ is the most the policy will pay for the sum of all the losses occurring within a policy period.

a. Contribution by Equal Shares  
b. Excess Liability  
c. Combined Single Limit  
d. Aggregate Limit

Retention Question 10

The ______ Limit of liability applies to bodily injury, property damages, or both.

a. Contribution limit  
b. Excess limit  
c. Combined Single  
d. Limit