

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

I. Employers Liability Exposure - Revisited

- A. Despite the existence of workers compensation laws, the employer can in some instances still be sued under common law for work-related accidents.
- B. When a worker is outside the scope of workers' compensation laws, he or she retains the right to sue the employer under common law.
- C. If sued by an employee under common law, the employer still retains the same common law defenses mentioned earlier (assumption of risk, contributory negligence, "fellow servant rule").
- D. An additional defense available to the employer is the statute of limitations for bring suit. This varies by state. If the employee does not bring suit within the period of time defined by state statute, the suit could be time-barred.

II. Employers Liability Insurance Coverage - Revisited

- A. Insurer agrees to pay damages that the insured becomes legally obligated to pay because of bodily injury to an employee.
- B. The insurer also agrees to defend the insured against claims or suits seeking covered damages.
- C. The following are examples of ways an employer can be held liable under common law as a result of employee injuries.

1. "Third party over suit"

- Third party refers to a person or an organization other than the employer or employee
- Example: An employee of the insured sues a third party (such as a machine manufacturer) for an occupational injury. The third party then sues the employer, alleging that the employer was negligent in maintaining the machine and that the employer must therefore indemnify the manufacture for all damages that the manufacturer had to pay the employee.

2. Claims for care and loss of service - Suits by a dependent

The spouse of an injured or deceased person can obtain damages from the liable party for care and loss of services. These are also known as "loss of consortium".

- In some states, the law permits the spouse of an injured employee to recover for loss of consortium, even if the employee has collected workers compensation benefits
- In some states, the law permits family members other than spouses to make similar claims against a negligent employer.

3. Claims for consequential injury – Family members of an injured employee can suffer bodily injury as a consequence of injury to the employee.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

Example: An injured employee's elderly parent might suffer a heart attack upon being informed of the employee's work-related injury.

4. Dual capacity suits – Typically dual capacity suits involve products liability. That is, an employee, while working, is injured by a product manufactured by the employer. In essence, the employee sues the employer in its capacity as a manufacturer, rather than employer. The CGL coverage form specifically excludes dual capacity

Example 1: An employee is injured at work as a result of using faulty equipment manufactured by the employer.

- ✓ Employee sues the employer as an equipment manufacturer.
- ✓ Employers' liability coverage in the employer's WC & EL policy covers the employer for the dual capacity suit.

Example 2: Suit is brought against the employer by the employee for negligently providing emergency medical care.

Example 3: Suit is brought against the employer by the employee for negligently serving contaminated food in an employer owned and operated cafeteria.

III. Reasons Why Excess or Umbrella Liability Insurance Needed

- B. Difficulty in estimating maximum possible loss.
 1. Most property loss exposures have a reasonably clear maximum possible loss.
 2. In contrast, there is no comparable way to estimate MPL for most liability exposures.
 3. This is due to several factors:
 - a. Unpredictable accidents and outcomes reflecting uncertainty regarding:
 - i. Number of injured people
 - ii. Extent of injuries
 - iii. Extent of property damage
 - b. Societal change – rising sense of entitlement, resulting increasing litigiousness.
 - i. Before 1962, there were no million dollar verdicts in U. S.
 - ii. The following percentages of verdicts exceeded \$1 million in 2001 and 2002:
 - 65% - products liability
 - 52% - medical professional liability
 - 17% - premises liability
 - 5% - vehicular liability
 - c. Unpredictable court awards

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

- i. Products liability – \$104.5 million – alleged design flaw – drain did not have a cover. Teenager died as a result.
 - ii. Premises liability – \$100.7 million – apartment complex had broken fence around pool. Unsupervised infant fell into pool and died.
 - iii. Medical professional liability – \$40.4 million – Patient having cosmetic surgery died on operating table from too much anesthetic.
 - iv. Auto liability – \$40 million – Intoxicated driver struck plaintiff’s vehicle head-on
 - v. Liquor liability – \$39 million – Restaurant served free drinks to customer who later hit couple with car.
- C. Need to layer coverage
1. Insurers providing primary liability limits are often unwilling to provide limits above \$1 million
 2. Excess or umbrella liability insurance provide the higher layers of coverage desired.
 - a. With reference to the excess or umbrella liability policy, the insurance in the lower layer is called **underlying insurance**.
 3. The primary layer in an insurance program is not always financed through insurance.
 - b. For example, a large business might decide to retain the first \$500,000 of its liability losses and buy excess liability to pay for losses exceeding \$500,000
- D. Aggregate limits exhausted
1. Some liability insurance policies (notably the CGL) have both per occurrence and aggregate limits.
 2. An insured might never suffer losses that exceed the “per occurrence” limit, but frequency might cause losses to exceed the aggregate limit.
 3. Example: CGL policy with:
 - a. \$1 million each occurrence limit
 - b. \$2 million general aggregate limit
 - c. \$2 million products-completed operations limit
 - Insured has 4 products losses for \$500,000 each during the policy period.
 - The policy will pay nothing for any other products liability losses that occur during the policy period, even if subsequent claims are below the \$1 million each occurrence limit
 - By purchasing an excess or umbrella policy, the insured would have the necessary coverage.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

IV. Excess and Umbrella Liability Policies Compared and Contrasted

- A. Excess and umbrella are insurance terms that are not consistently used or understood. Confusion arises from the fact that:
 - 1. Both the courts and insurance professionals use the terms interchangeably.
 - 2. Policy forms are not standardized.
- B. Excess and umbrella insurance both provide excess limits of liability coverage above the limits of the underlying policies.
- C. However, an excess policy provides no broader protection than that provided by the underlying coverage.
 - 1. The excess policy may even have more restrictive coverage.
 - 2. For example, the excess policy may not provide defense coverage.
- D. An umbrella policy is a type of excess policy that provides coverage not available in the underlying coverages.
 - 1. The additional coverages are subject to the insured's assumption of a self-insured retention.
 - 2. Since the umbrella is an excess policy, it provides additional limits above the limits of the underlying policies
 - 3. Most umbrella policies provide defense coverage
- E. Although commercial umbrella policies vary, they include a number of common characteristics:
 - 1. Umbrella policies provide high limits of liability
 - 2. The Insured is required to carry minimum underlying limits before an Insurer will write an umbrella policy.
 - 3. The umbrella policy covers some losses not covered by the underlying policies, after the Insured pays a self-insurance retention.
 - 4. The umbrella policy provides coverage for losses attributable to bodily injury and property damage liability, personal injury and advertising liability.
- F. White-board exercise: Compare \$1,000,000 each occurrence Excess Policy with 1,000,000 each occurrence Umbrella Excess Policy, subject to a self-insured retention of \$25,000.

V. Basic Kinds of Excess Liability Insurance

- A. Following-Form Excess Liability Policy
 - 1. Covers a liability loss that exceeds the underlying limits only if the loss is covered by the underlying insurance.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

2. True following-form policies:
 - a. State that, except for the policy limits, all of the provisions and conditions of the designated underlying policy are incorporated into and adopted by the excess policy.
 - b. Contain no provisions conflicting with the underlying policy
 3. Many policies that are called “following-form” are actually more restrictive than the underlying policy. This is because either
 - a. The excess policy contains its own, more restrictive provisions, or
 - b. The excess policy contains endorsements limiting coverage.
- B. Self-contained Excess Liability Policies**
1. Are subject to their own provisions only.
 - a. Coverage applies only to the extent described in the policy.
 - b. The policy does not depend on the provisions of the underlying policies to determine the scope of coverage.
 2. Because self-contained excess policies are independent of the underlying policies, coverage gaps can occur
 3. For example, a self-contained policy may not cover injury within the products-completed operations hazard. In that case, the excess policy would not pay for a products liability claim, even if the claim exceeded the occurrence limit of the underlying policy.
- C. Combination Excess Liability Policies**
1. These policies combine the following-form and self-contained approaches.
 2. Typically combination policies incorporate provisions of the underlying policy and then modify those provisions with additional conditions or exclusions in the excess policy.
 3. One type of combination form is an excess liability policy that provides broader coverages normally found in an umbrella policy
 - But, without any obligation to “drop down” and provide primary coverage, when a claim is excluded in the underlying policy, but covered in the excess policy (except to replace depleted aggregate limits).
 4. Key point: A distinguishing feature of a true umbrella policy is that the broader coverage provided applies over a self-insured retention.
 - In the absence of this provision, the policy is probably not a true umbrella policy.
- D. Specific Excess and Aggregate Excess Liability Insurance – Commonly used in connection with self-insured workers’ compensation plans.**
1. A specific excess liability policy requires the Insured to retain a stipulated amount of loss from the first dollar for all losses resulting from a single occurrence.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

- The insurer pays losses in excess of the retention subject to the policy retention.
- 2. An aggregate excess liability policy is also called a **stop loss excess liability policy**.
 - The Insured is required to retain a specified amount of loss from the first dollar during a specified period of time, usually one year.
 - The insurer then pays all loss for that period that exceeds the retention.
- 3. Combination Specific Excess and Aggregate Excess Liability policies
 - These policies provide the Insured with the benefit of both approaches.
 - If a particular loss exceeded the amount stipulate for a single occurrence, the Insured would collect the excess amount from the Insurer subject to the policy limit.
 - If none of the losses during the policy period exceeded the each occurrence retention, but the total losses for the period exceeded the aggregate retention, the Insured would collect from the insurer the amount of the loss in excess of the aggregate retention.

VI. Umbrella Liability Insurance

- A. As noted earlier, an umbrella liability policy is a special kind of excess policy.
 - 1. The distinguishing feature of an umbrella policy is coverage that is broader in some respects from that of the underlying policies.
 - 2. In contrast, ordinary excess policies tend to have the same provisions as the underlying coverage or even narrower provisions.
 - 3. Although ordinary excess policies may apply in excess of only one underlying policy, an umbrella policy applies almost universally over several primary coverages, such as:
 - CGL
 - Auto liability
 - Employers' liability

B. Basic Functions of Umbrella Liability Policies

- 1. Provide additional limits above the each occurrence limits of the insured's underlying policies.
- 2. Take the place of the underlying insurance when underlying aggregate limits are reduced or exhausted.
- 3. Cover some claims that are not covered by the insured's underlying policies, subject to a self-insured retention.

The latter two functions are frequently referred to as **drop-down coverage**.

C. Self-Insured Retention

- 1. When a claim covered by an umbrella policy is not covered by any of the underlying policies, the drop-down coverage is subject to the policy's self-insured retention (SIR).

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

2. The SIR does not normally apply when the umbrella is paying in excess of a claim covered by the primary policy or dropping down to pay a claim because the primary policy's aggregate limit has been exhausted.
3. Self-insured retentions vary in amount from as low as \$500 for small businesses to \$1 million or more for large businesses.
4. Coverage for defense costs is covered in full, often referred to as **first-dollar defense coverage**.
5. Self-insured retentions differ from deductibles in that insureds generally handle all claims falling within the self-insured retention.
6. Insureds need not report claims falling within the self-insured retention to their insurer unless the policy specifically requires this.
7. In contrast, policies with deductibles require the insured to report all claims within the deductible for processing, recording and payment.
8. Typically, claims subject to a deductible are paid by the insured in full, and the insured then reimburses the insurer for the amount of the deductible.

D. Required Underlying Limits

1. Each insurer writing umbrella insurance sets its own requirements for underlying insurance that the insured must comply with. These requirements include:
 - a. Types of underlying insurance
 - b. Amounts of underlying insurance
2. For example, an umbrella liability insurer might require the insured to have the following coverages and limits:
 - a. Commercial General Liability
 - \$1 million each occurrence
 - \$2 million general aggregate
 - \$2 million products-completed operations
 - b. Commercial Auto Liability
 - \$1 million combined single limit
 - c. Employers' Liability
 - \$100,000 bodily injury each accident
 - \$100,000 by disease each employee
 - \$500,000 disease aggregate
3. Additional types of underlying insurance might be required depending on the insured's loss exposure.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

4. Examples of underlying requirements:
 - a. Insured's business involves sale of alcoholic beverages and the umbrella insurer's policy contains no liquor liability exclusion.
 - Umbrella insurer will likely require underlying liquor liability insurance.
 - b. Insured owns a watercraft or aircraft that would be covered under the umbrella policy.
 - Umbrella insurer will likely require underlying watercraft or aircraft liability insurance.

E. Umbrella Limits

1. Umbrella limits apply in full in excess of each underlying coverage.
2. If an insured carrying underlying limits shown above purchased a \$10 million umbrella policy, total coverage for one occurrence covered by the CGL policy would be \$11 million.
3. However, total coverage for one employers' liability bodily injury claim would be only \$10,100,000.
4. If the umbrella policy included a \$25,000 self-insured retention for coverages provided on loss exposures not covered in the underlying policy, the full \$10,000,000 limit would apply over the self-insured retention.
 - That is, the limit is not reduced by the self-insured retention
5. Note: Each of the above examples ignores the impact of any aggregate limit in the umbrella policy.

F. Aggregate Umbrella Limits

1. Almost all umbrella policies contain aggregate limits that operate like aggregate limits in the underlying policy.
 - a. In some cases, the aggregate limit applies to all claims under the umbrella.
 - b. In other cases, the aggregate limit applies only to coverages that are subject to an aggregate limit in the underlying policy.
 - c. For example, the business auto policy does not have an aggregate limit.
2. When an umbrella policy contains an aggregate limit, its limit can actually be exhausted before the primary policy's limit is exhausted.
3. Example: Umbrella policy with \$10,000,000 each occurrence limit and a \$10,000,000 aggregate limit.
 - a. The Insured has a CGL with limits of \$1,000,000 each occurrence, \$2,000,000 general aggregate and \$2,000,000 products/completed operations aggregate.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

- b. If the Insured has an \$11,000,000 premises liability loss, the primary policy would pay its occurrence limit of \$1,000,000 and the umbrella policy would pay its full limit (occurrence and aggregate) of \$10,000,000.
- c. The primary CGL would still cover subsequent claims during the policy period, but the umbrella would not cover any additional claims.

G. Definitions

- 1. Ultimate Net Loss
- 2. Underlying Limit
- 3. Bodily Injury, Personal Injury, Advertising Injury, Property Damage
- 4. Occurrence
- 5. Defense Coverage

H. Umbrella Exclusions

- 1. The exclusions of the umbrella policies resemble many of those found in the underlying policies.
- 2. However, umbrella insurers also modify exclusions to either broaden or restrict coverages.
- 3. To achieve their coverage ends, an insurer may take any combination of the following actions.
 - a. Use some exclusions of the underlying policies with little or no change
 - b. Omit certain exclusions found in the underlying policies
 - c. Modify the exclusion to make it less restrictive than the underlying policy
 - d. Re-draft the exclusion to make it more restrictive than the underlying policy
- 4. Umbrella exclusions that are typically the same as the underlying policy exclusion include:
 - a. Expected or intended injury
 - b. Workers compensation and similar laws
 - c. War
 - d. Damage to your product
 - e. Damage to your work
 - f. Damage to impaired property or property not physically injured
 - g. Recall of products, work, or impaired property
 - h. Advertising and personal injury exclusions
 - i. Broad form nuclear injury
- 5. Underlying exclusions omitted from the umbrella policy. These come in two categories:
 - a. Exclusions that are omitted because they are not needed in the umbrella

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

- The employers liability exclusion of the CGL and business auto policies
 - The exclusions of operations and completed operations in the business auto policy
 - The CGL exclusion regarding transportation of mobile equipment by an auto
- b. Exclusions that are omitted to provide broader coverage in the umbrella than in the underlying:
- The CGL liquor exclusion
 - The employers liability exclusion of accidents occurring outside the United States or Canada
 - The employers liability exclusion of injury to persons subject to the Federal Employers' Liability Act, the Jones Act and similar laws permitting employees to sue their employers.
 - The employers liability exclusion of injury to persons knowingly employed in violation of law.
6. Umbrella exclusion that are drafted to be less restrictive than the underlying policy
- a. Watercraft and aircraft
 - b. Property in the care, custody and control of the insured.
7. Umbrella exclusions that are drafted to be more restrictive than the underlying policy
- a. Pollution
 - b. Punitive damages
- I. Other Umbrella Provisions
- 1. Maintenance of Underlying Insurance
 - 2. Concurrency
 - 3. Coverage Territory

VII. Structuring the Liability Insurance Program

- A. Review Handout

VIII. Bailee's Customer Policy

- A. A bailee is someone who has temporary possession of property that belongs to another party.
 - 1. Bailees are legally liable for damage to the customers' goods only if they or their employees are guilty of negligence.
 - 2. However, customers expect to be paid for the loss or damage to their goods regardless of who is at fault. If the customers are not reimbursed, the bailee may lose future business.

Class 17 Outline
Business Finance 749
Spring Quarter, 2007

- B. A bailee's customer policy can be used to cover the loss or damage to the property of customers regardless of the bailee's legal liability.
- C. Typical Insureds: Laundry; Drycleaner; Tailor
- D. The policy can be written on an "all risks" basis or named perils basis.
1. Named peril policy normally covers the following causes of loss:
 - a. Fire and lightning
 - b. Wind and hail
 - c. Explosion
 - d. Smoke
 - e. Riot and civil commotion
 - f. Vandalism
 - g. Burglary and hold up
 - h. Transportation risks
 - i. Confusion of goods (inability to identify goods that are not physically damaged)
 2. Named peril policy typically excludes:
 - Theft from an unattended vehicle unless vehicle is locked and there are visible signs of force entry
 - Loss from misdelivery or an unaccountable absence where evidence of theft is absent
 - Dishonest acts of the named insured or employees
 - Processing damage (unless caused by fire or explosion). Example: Tie damaged by poor pressing in the dry cleaning process would be covered.