

Legal Foundations of Liability Underwriting

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LEGAL LIABILITY: TORTS, CONTRACTS, AND STATUTES

Every person and all organizations are exposed to liability loss. The possibility of a liability loss is a **liability loss** exposure. To be able to identify, analyze, and properly handle an organization's liability loss exposures, one must understand the concept of **legal liability** and the common sources of liability loss exposures.

Anyone who wishes to evaluate an organization's liability loss exposures must understand the various ways in which the organization may become legally liable. Legal liability imposed by civil law can be based on torts, contracts, or statutes.

A liability insurance policy typically obligates the insurer to defend the insured against allegations that, if true, would be covered under the policy. Therefore, an organization can experience a liability loss even as a result of a suit in which it is not legally held liable. In addition, the policy obligates the insurer to pay damages for which the insured is legally liable. In most liability claims in which the insurer believes that its insured is legally liable, it attempts to settle the claim (by offering to pay a certain amount of damages to the claimant) in order to avoid the additional expense of a court proceeding.

Civil Law and Criminal Law

Legal liability can be imposed by **civil law**, **criminal law**, or both. Liability insurance responds to liability imposed by civil law. Insurance for criminal liability is prohibited by law.

In some instances, a single act can constitute both a civil wrong and a crime. For example, if a driver causes the death of a pedestrian, law enforcement authorities may charge the driver with vehicular homicide, a criminal act. The driver may also be subject to a civil action by the estate of the deceased pedestrian for medical bills, funeral expenses, loss of support, and other damages that the law allows. Insurance coverage would not respond to the criminal charges. It could, however, provide payment for the civil claims.

Civil liability can be based on torts, contracts, or statutes. See the exhibit "Bases for Legal Liability."

Liability loss

Any loss that a person or an organization sustains as a result of a claim or suit against that person or organization by someone seeking damages or some other remedy permitted by law.

Legal liability

The legally enforceable obligation of a person or an organization to pay a sum of money (called damages) to another person or organization.

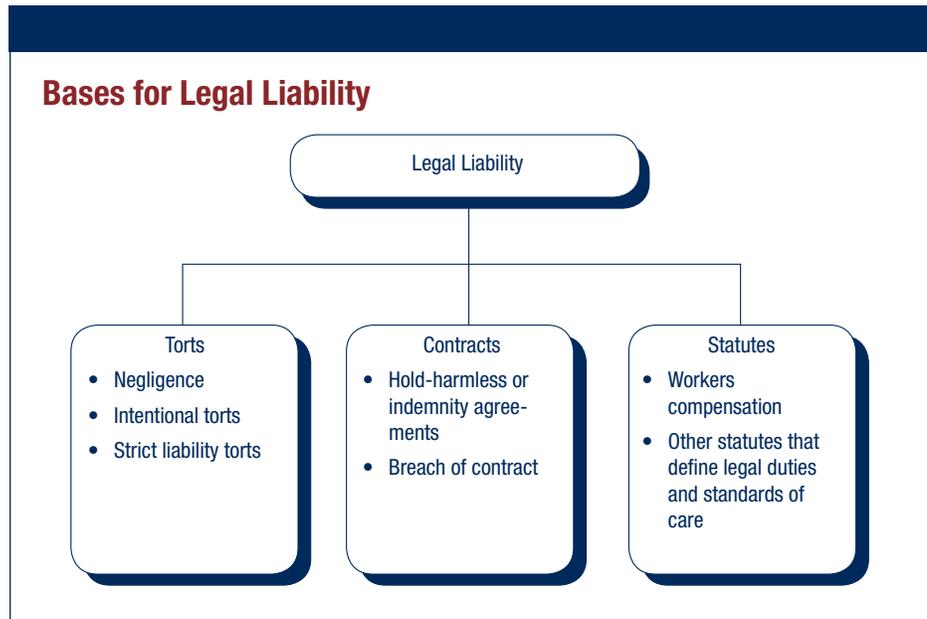
Civil law

A classification of law that applies to legal matters not governed by criminal law and that protects rights and provides remedies for breaches of duties owed to others.

Criminal law

The branch of the law that imposes penalties for wrongs against society.





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Legal Liability Based on Torts

Tort

A wrongful act or an omission, other than a crime or a breach of contract, that invades a legally protected right.

Torts may be civil wrongs or private wrongs. Most of the claims covered by liability insurance are based on tort law, which protects the rights of individuals. These rights originally included the rights to security of person, property, and reputation. Over the years, legal changes have established other rights of individuals, such as the right to privacy. Where a right exists, others have a corresponding duty to respect it and to refrain from any act or omission that would impair or damage it. Any wrongful invasion of legally protected rights entitles the injured party to bring an action against the wrongdoer for damages.

Underwriting Tip—Tort law varies by state. Liability underwriters should know tort law in general and the specifics of tort law in states in which they underwrite. To properly evaluate applicants for liability insurance, underwriters should also monitor related developments in state courts.

The numerous types of torts fall into three broad categories:

- Negligence
- Intentional torts
- Strict liability torts

Negligence is based on four elements:

- A duty owed to another person
- A breach of that duty

Negligence

The failure to exercise the degree of care that a reasonable person in a similar situation would exercise to avoid harming others.



- A close causal connection between the negligent act (breach of duty) and the resulting harm
- The occurrence of actual loss or damage of a type recognized by law and measurable in monetary terms

For example, a motorist who drives at an unsafe and excessive speed and, as a result, causes an accident that injures another motorist has committed the tort of negligence.

A negligent act does not in and of itself qualify as the basis for a negligence tort. All four elements of negligence must be present. For example, a motorist who is driving at an unsafe speed and who narrowly misses another vehicle has not committed the tort of negligence, although the act is negligent. The motorist who is driving negligently may receive a ticket, but the motorist whose vehicle was narrowly missed does not have the basis for a tort of negligence because he or she did not experience actual loss or damage.

An **intentional tort** is a tort committed by a person who foresees (or should be able to foresee) that his or her act will harm another person. The act does not necessarily have to be performed with malicious or hostile intent. An example of an intentional tort is libel, the publication of a false statement that damages a person's reputation.

Strict liability (or absolute liability) is liability that is imposed even though the defendant acted neither negligently nor with intent to cause harm. Common examples of strict liability include liability for abnormally dangerous instrumentalities (such as wild animals), ultrahazardous activities (such as blasting), and dangerously defective products (such as malfunctioning smoke detectors).

Strict liability is also used to describe liability imposed by certain statutes, such as workers compensation laws.

Legal Liability Based on Contracts

In addition to torts, **contracts** also impose legal liability. If one party fails to honor the promise, the other may go to court to enforce the contract. Liability based on contracts can arise out of either a breach of contract or an agreement one party has made to assume the liability of another party.

Breach of contract is a failure to fulfill one's contractual promise. A common type of breach of contract involves the promise (called a warranty) made by a seller regarding its product. If the product fails to fulfill its promise, the warranty has been breached, and the buyer can make claim against the seller. The warranty may be either expressly stated or implied by law. For example, the law implies a warranty that every product is fit for the particular purpose for which it is sold. If the product is unfit for its intended purpose and the buyer is injured as a result, the seller may be held legally liable for damages.

Intentional tort

A tort committed by a person who foresees (or should be able to foresee) that his or her act will harm another person.

Strict liability (absolute liability)

Liability imposed by a court or by a statute in the absence of fault when harm results from activities or conditions that are extremely dangerous, unnatural, ultrahazardous, extraordinary, abnormal, or inappropriate.

Contract

A legally enforceable agreement between two or more parties in which each party makes some promise to the other.

Breach of contract

The failure, without legal excuse, to fulfill a contractual promise.

