Chapter 29 Basis of the Liability Risk

The Significance of the Liability Risk

In contrast to direct damage losses, which can never exceed the value of the property, liability losses are virtually unlimited. There is also the very important possibility of loss arising out of the costs of defense. It is an established principle that the plaintiff in civil actions must bear the court costs of unsuccessful litigation. On the other hand, if the suit is successful the defendant is responsible for the judgment and his own costs of defense.

The liability risk is one of increasing importance - there are three major reasons that account for this:

1. Injured parties, real or fancied, have become more willing to press claims against others.
2. Inflation has resulted in higher awards.
3. There is "the jury problem."

Lawyers, specializing in liability claims, who have developed techniques leading to larger and often excessive awards represent only one aspect of this problem. The size of awards is, at times, influenced more by emotion than by facts. Perhaps one of the most significant characteristics of the liability risk is the fact that the full potential exposure cannot be measured accurately.

The Law of Negligence

The Liability Risk

The fact that, under our system of law, one can be held financially responsible for injury to another's person or property constitutes the basis of the liability risk.

The Law

Common and Statutory Law: The U.S. operates under a dual system of law. Statutory law which is the product of legislative enactment. Common law or unwritten law because it has been enacted into statute law. Common law derives its authority from usages and customs, or from prior court decisions.

The doctrine of stare decisis is a policy of the courts and means that once a principle of the law is found applicable to a given set of facts, the court will adhere to the established principle and apply it to future cases involving the same or similar facts. Statutes can be enacted, of course, which alter, amend, or modify any principle of common law.
Criminal and Civil Law: The field of law is also divided between criminal law and civil law. Crimes are wrongs against the state, contrary to the public interest. Action is brought by the state, the consequence is fine and/or imprisonment.

Civil law deals with acts which are not against society as a whole, but rather injury or loss to another individual. There are two divisions of civil law: (1) the law of contracts and (2) the law of torts.

The law of contracts is concerned with the enforcement of rights and duties. Liability risks arising out of contracts are important but limited in scope. The vast majority of significant liability risks arise out of torts.

"A tort is a wrongful act or omission, arising out of social relationships other than contracts, which violates a person's legally protected right, and for which the law provides a remedy in the form of action for damage."

An intentional tort is an act which is committed for the purpose of injuring another's person or property. Assault and battery, false imprisonment, and libel and slander are examples. These risks are typically excluded in a basic liability policy and are identified and insured separately.

A second class of torts involves statutory liability. In such situations the injured party need only show that the event occurred and he is automatically entitled to recovery of money damages. Example: Workmaen's Compensation Statute

A rapidly emerging concept is one of absolute or strict liability. Under certain circumstances, a person may be held liable even though the person being held liable used all reasonable care to avoid injuring another. Society is saying that the activity is so dangerous to the public that liability must be imposed even though no fault is present. The insurance implications for areas involving air and water pollution, oil spills, and blasting are almost unlimited.

Principles of Negligence Liability

The law is neither exact or fixed for all time. In order to have an appreciation of the liability risk, one must understand its basic principles. In no area are the modifications greater or the principles more important than in the area of negligence.

Negligence Torts: Negligence torts provide the basis of a major part of the liability risk. The distinguishing characteristic is that the invasion of another's rights was the result of neglect or carelessness on the part of the one causing the injury.
Negligence Defined: Negligence has been defined as the failure to use that degree of care required by law of a prudent man under the same or similar circumstances.

Six ideas are involved in negligence.

1. Failure is intended to convey the idea that the wrongdoer, was in a position to exercise control over the occurrence of the event.

Failure to exercise prudent care also implies that there was no intent to injure another (intent to injure which would render the act an intentional tort). The concept referred to as foreseeability has been defined as "the ability to see or know in advance, hence the reasonable anticipation that harm or injury is the likely result of acts or omissions."

Negligence is not actionable unless it involves the invasion of a legally protected interest, the violation of a right.

2. The second prase, in the definition of negligence, use that degree of care required by law, indicates that there is no single standard of care for all circumstances. The degree of care required is established in relation to some social, moral, or legal standard. The courts have said that with regard to children, one must exercise a high degree of care.

3. A prudent man is neither superior or inferior to what is regarded as a reasonable and responsible member of his society. The court imputes to this prudent man a set of moral standards which are generally recognized and acceptable. Identifying and measuring the standards of a prudent man is a function of the court, that is the jury.

4. Same or similar circumstances must also be considered in establishing negligence.

5. The injury must be a consequence of the negligent act in order to provide a course of action. The claimant must show that he has suffered a loss to his person or his property, to be eligible to recover money damages. The concept of what constitutes an injury is subject to change also.

6. Direct result is the final part of the definition. The negligent act must be the proximate cause of the injury is there is to be a complete action. It must be demonstrated that there is an unbroken chain of causation from the negligent act to the resulting injury.
Defenses Against Liability

The burden for establishing the facts to assign negligence rests on the one claiming money damages for an injury, the plaintiff. The defendant may satisfy the court that one or more of the prerequisites is missing, thereby disclaiming any responsibility.

In common law, there are two other basic defenses. The first is contributory negligence. The defendant need only show that the plaintiff, even to a slight degree, was partially responsible for the injury because of some of his negligence and the defendant is relieved. Contributory negligence can be avoided if the defendant is guilty of gross negligence or he had the last clear chance to avoid the consequences of the plaintiff's negligence.

A second common law defense is called assumption of risk. If the injured party was (1) aware that there was an existing risk, and (2) voluntarily exposed himself to the risk, he has no action at common law.

Modifications of Negligence Law

Common Law Modification - Involving Degrees of Care

Visitors on Another's Property - The trespasser is owed the least care. If he has notice of frequent trespassers, he has a duty to look before engaging in any dangerous activity. A licensee is one who comes on the premises with the express or implied consent of the owner but for his own purposes. The owner or tenant owes to such a person the duty of disclosing any known dangers. The invitee, a customer in a store, for example, is entitled to a reasonable degree of care; i.e., that the premises are in a safe condition.

Visiting children and certain other groups are typically regarded as special classes of persons and the tenant owes to them a reasonable degree of care even though they may be on another's property as trespassers.

Attractive Nuisance - This concept involves a dangerous condition on the premises which would tend to entice others to trespass. Historically, the application of this doctrine was restricted to children under 14.

Dangerous Instrumentalities - Common law takes the position that one having possession of a dangerous instrument is absolutely liable for the injury it may cause. Firearms and explosives are typical examples. Less common is a wild animal. The owner of a domestic animal is expected to exercise only reasonable care unless the animal is known to be dangerous, in which case absolute liability would apply.
Extra Hazardous Operations - The doctrine which places absolute liability on those performing operations inherently dangerous to the public, e.g. one who was doing blasting

Modifications of the Need for Proof of Negligence

In some cases, negligence may be presumed because of the facts of the case. The legal doctrine res ipsa loquitur (the thing speaks for itself) establishes prima facie evidence of negligence. Three typical situations - (a) where the defendant has superior knowledge of the cause of the accident, (b) where the instrument causing the injury would not ordinarily do so without negligence, and (c) where the injuring instrument is within the sole control of the one to be held responsible.

Very similar to the above but stronger is negligence per se. This is the unexcused violation of a statute designed to protect a person or class of people, of which the plaintiff is a member, from the resulting harm.

Last Clear Chance - States that even though there was a negligent act on the part of another, if the second party had the last clear chance of avoiding injury and did do so, he forfeits his cause of action.

Gross Negligence - This doctrine enables the plaintiff to avoid the consequences of contributory negligence if the defendant's negligence was of a variety called gross negligence or willful and wanton disregard of the rights of others.

Acts of God - Exceptional forces of nature may cause one's property to injure another's but the owner could disclaim liability because of an unforeseeable intervening force.

Trustees - One holding the property of another in trust is held responsible for a high degree of care to protect the property. If the situation arises, the trustee, where negligent, must stand personally responsible for the injury to a third party or damage to another's property.

Professionals - One who occupies the position of professional is required to use a high degree of care to avoid injury to those entrusting their person or property to him.

Governmental Units - One modification or exception to the principle of negligence also inherited from England, was that of governmental immunity. Inasmuch as the king had sovereign power over all law, there followed the concept that the king could do no wrong. The courts in the United States substituted the federal and state governmental units for the king. This basic rule still prevails.
The court has also modified governmental immunity in regard to functions carried on under the auspices of government but which are not considered uniquely governmental. Cases involving city-owned hospitals, public transportation, and even some aspects of the school systems, such as sports events, have been held to be nongovernmental and therefore not subject to tort immunity.

Charitable Institutions - Organizations that are voluntarily operated for the public good, such as churches, schools, etc., have been considered to have immunity. One line of reasoning is the extension of government theory - the institutions are performing functions which, in the absence of charity, would have to be assumed by the government. A second justification is referred to as the trust fund theory. Donations to the institutions are held in the form of a trust exclusively for the support of the public good. The payment of any tort claim would constitute a breach of this public trust. At the present time, court decisions are modifying - the trend is generally toward the elimination of charitable immunity rather than its extension.

Responsibility for the Acts of Others -

Parent and Child - The common law takes the general position that a parent is not responsible for the torts of a child or minor. Major exceptions (a) the act of the child is at the direction (agent) of the parent (b) the child is entrusted with a dangerous instrument (c) the family purpose doctrine is applicable, or (d) the parent ratifies the tort of the child.

Principal-Agent - The principle of respondeat superior, i.e., the master is liable for the torts of his servant, is basic in common law.

Statutory Modifications

Statute of Limitations - The party claiming injury must bring his claim to the court within a reasonable period of time. This is a procedural statute. It neither establishes nor extinguishes the basis of the suit but merely regulates the time within which it must be brought. The time limitations in these statutes vary from one to five or more years.

Comparative Negligence - Nearly 30 states have adopted a comparative negligence rule. They can be divided into 2 types.

(1) Wisconsin or 50% comparative negligence system. Damages are allocated in proportion to fault but only up to the point where the plaintiff's fault equals or exceeds that of the defendant. At that point, the plaintiff is barred from recovery.
(2) California or pure comparative negligence system Liability is assessed in direct proportion to fault of the person whose negligence has brought such damages about.

Disadvantages - It is obvious that there are more law suits and that there are more law suits which involve complex cases.

Guest Statutes - Law limiting tort action have been adopted in two types of guest situations.

Innkeepers - At common law, innkeepers are held to absolute liability for the property of guests without regard to negligence. Only exceptions - (a) an act of God, (b) a public enemy, or (c) negligence of the guest claiming damages. In some states, statutes have been enacted limiting the liability of the innkeeper to some maximum amount (often $500), if a place of safe keeping is made available for valuable articles.

Automobiles - An injured guest in an automobile operated by another, under common law, has an action if he can show ordinary negligence. Thirty states have enacted legislation which deprives the guest plaintiff of a claim against his host owner or driver unless he can show "gross negligence". Its justification is based largely on the fact that it discourages fraud through collusive claims.

Aircraft Liability - Some states have enacted laws which, in effect, protect the air space immediately above one's property. The law that grants public use of air space also may impose absolute liability on the aircraft owner for injury to persons or property beneath the flight, caused by the flight or the dropping or falling of any object.

Products - In the case of goods designed for human consumption, common law has moved in the direction of imposing absolute liability on the producer. The injured party need only show that the product was unfit for the purposes intended and that injury resulted. Of recent interest have been the cases involving the need for warning smokers of the potential hazards involved in the use of cigarettes.

Survivors' Right to Sue - At common law, a tort action is personal and upon death any rights to sue or be sued also die. Statutes and courts have placed legal representatives in the place of the deceased. One's estate may inherit a tort action even after death if the act preceded the demise of the tort feasor (the one committing the tort). Interesting cases arise when there is a question as to whether the driver of an auto died of a heart attack prior to an accident. If the driver had no warning, he may not be negligent and thus not responsible for the accident.
Employer-Employee - At early common law, an injured employee could successfully sue his employer if he could prove that negligence on the part of the employer was responsible for his injury. During the 19th Century common law modified the degrees of care required first to the benefit of the employer and later a limited relief to the injured employee. In the second decade of the 1900's, state legislatures enacted statutes which placed absolute liability on the employer for damages resulting from injuries to employees arising out of and during the course of employment.

Automobile Accident Victim - For many years the auto has been regarded as a mixed blessing. It has become among the lethal weapons devised by man. Statutes touching on the problem can be divided broadly into two parts. There are those which attempted to guarantee that the innocent victim under the negligency system, can press his claim against a responsible party who is financially able to respond. The second approach is the no-fault plans.

No-fault plans propose to eliminate the tort liability system as it applies to victims of auto accidents and substitute a plan in which the injured party is responsible for his own loss.

Functions of the Courts

Classification of Courts - District courts or trial courts have original jurisdiction in most cases falling within the scope of federal law. The Courts of Appeals and the Supreme Court of the U.S. are principally courts of appeal reviewing decisions of lower courts. The district courts have jurisdiction of tort cases involving money damage claims by the public. District Courts are also the original courts for all civil cases involving admiralty and maritime jurisdiction and in suits between citizens of different states where the amount in controversy exceeds $10,000.

Court Procedure - One who believes he has suffered an injury and seeks relief is known as the plaintiff and he brings a law suit against the defendant. Civil action usually begins with the plaintiff filing with the court of jurisdiction a declaraton or complaint in which he sets forth the facts of his claim. The court will transmit a copy of the complaint to the named defendant(s) referred to as service of process.

The defendant must answer within a limited period of time. If there is no response, a judgment by default is entered for the plaintiff. When a defendant files an answer, he must admit or deny the facts. If there is a question of facts, there must be a trial to determine these facts. Either party has the right to demand and receive a trial by jury.

The jury's duties are twofold - 1) the jury must determine the facts. 2) If the acts in question are found wanting and negligence is established, the jury must then make a recommendation as to the amount of money damages
Special damages are for such rather easily identifiable out-of-pocket items as medical expenses and loss of earnings. General damages are less definite and are awarded for pain and suffering.

Should a plaintiff obtain a judgment, there is no guarantee within the process that the defendant will be financially capable of satisfying judgment. Many injured victims cannot personally finance such litigation. As a result, the plaintiff's attorney will take the case on a contingent fee basis. In other words, the attorney will take one third or more of the amount recovered.

Liability Risk Treatment

One committing a wrong may be held obligated for money damages, i.e., liable. There may be alternatives available for meeting the exposure to loss. The standard methods of (a) eliminate or reduce the hazard or (b) eliminate or reduce the undesirable financial consequences of the hazard may be applied.

Elimination or reduction of the financial consequences of the liability hazard is essential in all situations. Three principal methods may be used to treat the residual hazard: (1) reserve accumulation, (2) transfer the risk to another, and (3) combination of risks.

In virtually all situations, reserve accumulations or savings are at risk. The exposure of reserves may be informal as in the use of deductibles. The deductible is less used in the liability area than is true of direct damage insurance, but there are high frequency situations which make it attractive. The reserve exposure may be as formalized as a true self insurance plan.

The transfer of the liability risk to others is accomplished in two major ways: (a) the legal device of limiting exposure to loss through incorporation and (b) use of a legal contract to transfer the risk.

The best known and most widely used contractual transfer device is the Hold Harmless Agreement. This does nothing to diminish the risk; it merely transfers it from the party on whom liability would normally fall to another who assumes the same liability exposure. The indemnitee is the party assuming the obligation to hold the indemnitee harmless for any liability covered by the contract.

Liability risks, characterized by their low frequency but potentially high severity of loss, make them excellent subjects for insurance. Their one major failing is the absence of a known maximum total loss. To date, insurance companies have been unwilling to write contracts assuming all the legal liability of the insured.
LEGAL LIABILITY ONLY IF:

1. NEGLIGENCE
   Obligation to Protect
   Failure to Protect

2. ACTUAL DAMAGE OR LOSS

3. NEGLIGENCE WAS PROXIMATE CAUSE
LIABILITY DAMAGES INCLUDE:

A. PROPERTY DAMAGE — PD —
Anything except bodily injury to people

B. BODILY INJURY — BI —
1. Medical Costs
2. Loss of income
3. Pain and Suffering
   — including loss of use —
4. Mental Anguish

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NEGLIGENCE DEFINED

Common Law

Prudent Man Rule
Visitors to Premises
Vicarious Liability
Governmental Immunity
Charitable Immunity

Statutory Modifications

Comparative Negligence
Last Clear Chance
Gross Negligence
Strict or Absolute Liability

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COMPARATIVE NEGLIGENCE

Statutory Modification of common law.
Each party pays for the portion of the loss based upon negligence.

Driver A
20 percent at fault
$1,000 in damages

Must pay:
$10,000 x 20% = $2,000
$1,000 x 20% = $200 (to self)

$2,200

Driver B
80 percent at fault
$10,000 in damages

Must pay:
$10,000 x 80% = $8,000 (to self)
$1,000 x 80% = $800

$8,800

A would pay to B: ($2,000 - $800) = $1,200

NOTE: If in a comparative negligence state, neither driver could collect. In this case, Driver A is at a disadvantage under comparative negligence.

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Figure 21-1

EXCESS UMBRELLA POLICY
(provides excess limits in all these areas to top of dotted lines)

Personal injury; malpractice; auto, aircraft, and watercraft; contractual (blanket); water damage; liquor law; warehouse's advertiser's; property in care, custody, and control; worldwide coverage; etc.

Deductible - $25,000

Type of liability coverage
- BI
- BI
- BI
- PD
- PD
- PD
- PD
- Comp.
- EL

Type of liability limit
- +
- Per
- Per
- Prod.
- Prod.
- Contr.
- Unlim.
- Per
- Acc.
- Pers.
- Occ.
- Agg.
- Acc.
- Agg.
- Agg.
- Occ.

Type of liability policy
- AUTO COMPREHENSIVE GENERAL
- LIABILITY WORKERS' BAILEE COMP.

Combined single limit for each of above liability coverages, over the deductible

EXCESS UMBRELLA