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How to Read a Liability Insurance Policy

By GEORGE K. HARTWICK*

THIS PAPER is intended to serve as an introduction to the legal problems involved in the subject of public liability insurance, and to offer some suggestions to a person faced with an insurance coverage question for the first time. Necessarily, the discussion will be general, and, while specific reference will be made only to the policies most commonly used, the suggestions made should be equally applicable to all liability policies currently in use by insurers.

Most insurers use standard forms of liability policies. The two forms in most general use are the comprehensive general liability policy (the form issued to business enterprises) and the family automobile policy.¹

These forms represent a modern approach to insurance. They are packages of several kinds of coverages, which before these forms were adopted had to be purchased separately. The comprehensive form, for example, includes, for specified premiums, third party liability protection for premises—business operations, products liability, property damage, and automobile liability. The family automobile policy is a broad, recently adopted form, which is now almost uniformly issued to individuals.

An insurance policy is, of course, a contract; but it is no longer possible to approach an insurance problem simply by resort to the law of contracts. A substantial body of law has developed which is particularly applicable to contracts of insurance, and different from that applicable to contracts generally. Any coverage question must be examined in the light of this new body of rules.

The most significant of these rules is that a policy is to be interpreted against an insurer and in favor of an insured. The courts say that a policy will be interpreted to afford coverage if it is "semantically permissible"² to do so.

The policies currently in use have developed over a period of years. They are complex, since they are designed to cover a wide variety of

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¹ Forms of personal comprehensive liability insurance are also in general use; however, because of the nature of their coverage, they will not be discussed in this paper.

² *Continental Cas. Co. v. Phoenix Constr. Co.*, 46 Cal. 2d 423, 437, 296 P.2d 801, 809 (1956).

circumstances, and a first reading of a policy may leave a person confused. There is, however, a method of reading them which eliminates much of the confusion.

A policy is composed of three parts:

- (1) Insuring Clauses
- (2) Exclusions
- (3) Conditions

The insuring clauses describe, in general, two things: (1) certain *events* which are covered; and (2) certain *persons* whom the insurer will protect against the consequences of those events. Liability policies almost always protect, as "insureds," groups of persons in addition to the "named insured." These persons are described in the insuring clause entitled "Definition of Insured." The result is that in a great many cases, more than one policy will protect a person who has been involved in an accident. In modern policies, the insuring clauses are very broad, and include events and classes of persons which the insurers do *not* wish to cover. The purpose of the exclusions is to eliminate these events and persons from the broad terms of the insuring clauses. The conditions contain definitions of terms, and duties of the insured.

This is the way to read a liability insurance policy:

First, examine the insuring clauses to determine these two things: whether the *event* is within the scope of the policy and whether the *person* claiming protection is within that insuring clause which defines the "insured." If both the event and the person are covered, then turn to the exclusions to determine whether either the event or the person is eliminated from coverage. If neither is excluded, then read the conditions to determine whether the person claiming protection has complied with the conditions of the policy.

If the event and the person are within the insuring clause, and neither is excluded, and the conditions have been complied with, coverage exists. There are, of course, certain warranties made by the insured in his application. These are normally set forth in the "Declarations" (that portion of the policy which identifies the named insured, describes what coverages are purchased, and states the limits of liability). A breach of warranty may give the insurer a right to rescind.

This approach to any coverage question almost necessarily results in a correct answer. Some caution must be exercised, however, in reading these three portions of the policy, and we will discuss each of them to point up, by example, where care must be exercised.

The Insuring Clauses

Certain words in the insuring clauses may, either because they are defined in the policy or because case law has given special significance to them, mean something different from what they might otherwise be expected to mean. Insuring clause I of the family automobile policy, for example, reads as follows:

To pay on behalf of the insured all sums which the *insured* shall become *legally obligated to pay as damages because of:*

A. *bodily injury, sickness or disease, including death resulting therefrom, hereinafter called "bodily injury," sustained by any person;*

B. *Injury to or destruction of property, including loss of use thereof, hereinafter called "property damage";*

arising out of the ownership, maintenance or use of the owned automobile or any non-owned automobile, and the company shall defend any suit alleging such bodily injury or property damage and seeking damages which are payable under the terms of this policy, even if any of the allegations of the suit are groundless, false or fraudulent; but the company may make such investigation and settlement of any claim or suit as it deems expedient.

Many of the words used in the quoted clause (particularly those underlined) have a special meaning. For example, the clause would appear to cover all liability resulting from the use of *any* automobile, since it refers to both owned and non-owned automobiles. Such is not the fact, however, since the policy defines the terms "owned" and "non-owned" automobiles. A "non-owned" automobile is defined in a manner which eliminates from coverage automobiles furnished for the regular use of the named insured, and eliminates any automobiles owned by or furnished for the regular use of any relative residing in his household. On the other hand, an "owned" automobile includes more than what would normally be understood by the reader of the policy. It includes a "temporary substitute automobile." Again, the word "automobile" includes a trailer.

The Comprehensive General Liability policy defines automobiles differently. It sets up three classes: "owned," "hired," and "non-owned," and the definitions are different from those contained in the family automobile policy.

Insureds are protected against claims arising out of the "ownership, maintenance or use" of the defined automobiles. The word "use" has been given a very broad meaning by the courts. If, for example, a person were loading or unloading goods into or from the automobile, and on the way to or from the car bumps into and injures a pedestrian, the resulting claim arises out of the "use" of the automobile and is

covered.³ One significant point here is that the automobile need not be, in the legal sense, the proximate cause of the claim; the events giving rise to the claim must, however, arise out of and be related to its use.

The definitions of persons insured (commonly referred to as the "omnibus" clause) must also be read in the light of the definitions of "owned" and "non-owned" automobiles. The omnibus clause refers to "relatives," but this word is defined in the policy to mean something special: it means a relative *residing in the same household* as the named insured.

The defense clause imposes upon the insurer the obligation to defend and requires it to pay defense cost *in addition to* the limits of liability. This wording has led the courts to conclude that the obligation to defend is separate from and independent of the insurers' obligation to pay a judgment.⁴ One of the consequences of this is that in some cases involving multiple claims arising out of one accident, an insurer may be obliged to continue to defend the insured long after its limits of liability have been exhausted.

In the Comprehensive General Liability policy the principle is the same: the insuring clause must be read in the light of special meaning given to defined words. The coverage and the definitions, however, are different. The basic insuring clauses of this form read:

Coverage A—Bodily Injury Liability

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person.

Coverage B—Property Damage Liability—Automobile

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of injury to or destruction of property, including the loss or use thereof, *caused by accident* and arising out of the ownership, maintenance or use of any automobile.

Coverage C—Except Automobile

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of injury to or destruction of property, including the loss of use thereof, *caused by accident*.

It is hard to conceive of any broader statement of coverage than is contained in this insuring agreement. Coverages B and C are said to

³ See *Maryland Cas. Co. v. Tighe*, 115 F.2d 297 (9th Cir. 1940).

⁴ *Burchfield v. Bevans*, 242 F.2d 239 (10th Cir. 1957); *American Cas. v. Howard*, 187 F.2d 322 (4th Cir. 1951); *Anchor Cas. v. McCaleb*, 178 F.2d 322 (5th Cir. 1949); *Firco, Inc. v. Fireman's Fund Ins. Co.*, 173 Cal. App. 2d 524, 343 P.2d 311 (1959).

be on an "accident basis," because protection is limited to damages "caused by accident." Policies which do not have this limiting phrase are said to be on an "occurrence basis." The clause phrase "caused by accident" creates three problems:

1. What is an accident?
2. When did the accident happen?
3. In a given case how many accidents have taken place?

The courts have defined "accident" scores of times, but for practical purposes the traditional definitions have lost their meaning. The fact is that courts today will deem a loss to have been "caused by accident" if the damage itself was not intended by the insured or not reasonably certain to result from the insured's actions. The distinction, therefore, between occurrence and accident is no longer as sharp as most underwriters believe it to be. In most cases, if the claim does not come within the public policy set forth in Insurance Code section 533 (which prohibits insurance against the consequences of wilful, intentional and unlawful acts) it is probably one which was "caused by accident."

The question of when an accident happens is an important one. Policies are written for fixed periods of time. Often there is an interval between the *cause* of an accident and the resulting damage. This is almost always true in products cases. There the negligent act normally occurs during manufacture and the damage will occur months later when the product is used. The question is, then, does the accident "happen" when the negligent act is done, or when damage occurs?

In one case⁵ a manufacturer of antifreeze was insured by Company A when it manufactured its product. The product was defective and, when poured into an engine, destroyed it. Company A's policy was replaced by one issued by Company B before any customer had used the product. Company B, however, received many claims of loss from people using the product.

The court held that an accident happens, for insurance purposes, when damage, or loss, occurs. Therefore, the particular insurer on the risk at the time the particular claimant suffers loss covers that claim. One important consequence of this is that an insured who terminates his business, or sells it, should continue his insurance protection for at least three years to cover accidents for which he is responsible, but which might occur after he ends his connection with the business.

The question of when an accident happens can arise also in connection with First Party coverage. The term "First Party" coverage is used to designate insurance indemnifying the insured against loss from or damage to himself, or to his own property. Protection against

⁵ Protex-A-Kar v. Hartford Acc. Co., 102 Cal. App. 2d 408, 227 P.2d 509 (1951).

liability to *others* is referred to as "Third Party" coverage.

In a cargo case,⁶ for example, tobacco was carelessly stowed in a hold of a ship and absorbed some fumes. The deterioration of the tobacco was gradual during the journey. Halfway through the journey one policy expired and another policy was written on the tobacco. The court held that each insurer was responsible for that portion of the damage which occurred while it was on the risk.

The rule, then, is that an accident "happens" when loss or damage is sustained by the claimant.

The third problem (how many accidents have happened) is quite important, in that it usually exists in cases involving substantial amounts of money.

To begin with, policies are written with two sets of limits: that is, a given amount in respect of each person injured, and a second, usually larger amount, as to each accident. Obviously, in a serious case involving multiple claimants, the insured has an advantage if more than one accident occurred. The limits are reinstated after each accident, and if two accidents have occurred, twice as much insurance is available.

In one case⁷ a fire broke out in a hotel. Numerous guests had claims against the hotel, and the latter claimed that in each case of damage to a particular guest a separate accident occurred. If this were so, the limits of liability of the hotel's insurer would be multiplied by the number of claimants. The court held that all damage arose out of one fire, and that all damage resulted from *one accident*. Another case⁸ involved an oil well which "gushed" out of control for a period of time. Each time the wind shifted, a different property owner was damaged. The court in that state adopted a different rule, and held that several accidents occurred.

The question of how many accidents have occurred gives rise to an even more serious problem where large risks are involved. Often these risks are self-insured for the first 50,000 or 100,000 dollars of each accident or occurrence. In such cases, the insurance over the deductible amount will be great: it will be for from one to ten or more million dollars. Suppose, for example, that a large company retains the first 100,000 dollars of loss for each accident, and has 1,000,000 dollars insurance (over the 100,000 dollars) for each accident. In a catastrophe loss, it may or may not be to the insured's advantage to have the losses result from one accident. If the cases can be settled

⁶ *Export S.S. Corp. v. American Ins. Co.*, 106 F.2d 9 (2d Cir. 1939).

⁷ *Denham v. La Salle-Madison Hotel*, 168 F.2d 576 (7th Cir. 1948).

⁸ *Anchor Cas. Co. v. McCaleb*, 178 F.2d 322 (5th Cir. 1949).

for 200,000 dollars, the insured is benefited if *one* accident occurred. If, however, the exposure is 2,000,000 dollars, the insured is better off if *two* accidents occurred. This doubles his exposure on the deductible (or retention) but it gives him an extra million dollars of excess insurance.

The examples given above are not intended to be full treatments of the problems mentioned, nor a statement of all of the problems involved: they are merely examples of the care that should be taken in reading the three parts of the policy. The suggestion is: each portion must be read in the light of the meaning, for insurance purposes, of the words or phrases used and defined in the policy.

The Exclusions

Our courts construe exclusions from coverage very strictly against insurers and in favor of insureds. This places a heavy burden upon insurers, since it is almost impossible to draft an exclusion which will clearly and explicitly apply to the limitless variety of factual patterns which can arise, and which are within the intent of the underwriter who drafted the exclusion. Any reasonable argument challenging the application of an exclusion to a given set of facts has an excellent chance of success.

The exclusions also must be read in the light of the special meaning of the words used. Most comprehensive general liability policies, for example, exclude liability assumed by contract. The word "contract," however, is defined in a manner which *includes* coverage of liability assumed in leases, sidetract agreements, etc.

Liability policies almost always exclude claims made for injuries to employees of the "insured." Often, the injured claimant is an employee of the *named* insured, but sues another person (not his employer) who qualifies as an "insured" under the omnibus clause. Most courts properly hold that the exclusions (and, indeed, the rest of the policy) must be read in the light of the *person claiming coverage*, and if the claimant is not an employee of the particular "insured" demanding protection, the exclusion does not apply.⁹

The Conditions

The coverage afforded by policies today is so broad that *any* potential claim against a client should be examined to determine whether his insurance may apply to it. This examination must, however, be made promptly, since the conditions impose certain duties upon the insured in respect of insured losses.

⁹ See Pleasant Valley Lima Bean Growers & Warehouse Ass'n v. California Farm Ins. Co., 142 Cal. App. 2d 126, 298 P.2d 109 (1956).

The insured must, for example:

- (1) Give the insurer prompt notice of an accident or potential claim;
- (2) Cooperate with the insurer in the defense of claims; and
- (3) Forward to the insurer all process served upon him.

A breach of these conditions could forfeit coverage which would otherwise have been available.

Conclusion

The suggestions to persons faced with an insurance coverage problem are these: examine every claim, and any events which might give rise to a claim, to determine whether the client is entitled to insurance protection, either (1) under his own policies; (2) his employer's policies; (3) policies held by members of his household; or (4) policies held by the owner of any "non-owned" automobile he was driving.

When a policy is reviewed for coverage, read it as though it contained three separate parts: determine whether the insuring clauses cover the client, and also cover the event giving rise to the claim. Then see if either the client or the event is excluded. Finally, if coverage exists, and is not excluded, make sure that the client has complied with the conditions of the policy.