Business Insurance Basics

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This practice note will provide you with a broad overview of common varieties of business insurance. It will also help you to better understand the theoretical underpinnings of insurance in general, the terminology, the process by which it is obtained, and how you, as the insured's counsel, can best advise a client on general business insurance issues.

For more information related to business insurance, see *Business Insurance Policies Review* and *Business Insurance Policies Interpretation*.

Fundamentals and Definitions

Fundamentally, insurance is a contractual arrangement in which one entity, the *insurer*, agrees to assume the *risk* of a financial loss sustained by another, usually called the *insured*. In this context, "risk" is best defined as the likelihood that an event resulting in financial loss may or may not occur. The assumption or shifting of the risk of loss is in return for the payment of consideration called a *premium*.

The assumption or "transfer" of risk occurs between the insurer and insureds with similar risk characteristics (or "exposures"). It is only if that commonality of risk characteristics exists that an insurer can properly assess the likely financial exposure and establishes a premium. The statistical concept called "the law of large numbers" enters the calculation of premium and the willingness of an insurer to assume the risk. The law of large numbers is a statistical principle involving an insurer's assessment of the frequency and size of losses of a large group of people over time. That information helps to predict the frequency and magnitude of future losses.

The Attorney's Role

Except in circumstances when insurance is mandated by law, a business entity has the choice of insuring against risks to which it may be exposed. If it decides not to, it is said to "self-insure." If a client asks for your input on the decision, it is important to understand that the decision is not wholly a legal one. Instead, there are many financial implications to it that may require a team approach involving internal risk management, the client's financial advisor, and possibly other allied professionals.

If the client decides to obtain insurance for a risk or for a range of risks it may or may not engage you to assist with procuring insurance. Often, small businesses do not use their attorney to do so. But you, perhaps in conjunction with an insurance professional can perform a valuable role in ensuring that the client understands the parameters and triggers of coverage. In some instances, insurers sell directly to insureds with no *agent* in-between (they are called direct-writers). In that instance, the client, in a sense, lacks an advocate like the agent can sometimes be by helping to assess risk and advise on the type, cost, and other factors that bear on the insurance transaction. If that's the case, you, as company counsel may have to assume a more active role. But again, unless you have particular insurance or risk-management expertise, client needs are better served by a team of professionals which you can assemble and even lead.

Obtaining Insurance

The insurer-insured relationship begins with an insurance *application*. The application is designed by the insurer to capture information based upon which, sometimes with other information, the insurer decides whether to accept the applicant as a risk. The analysis of that information is called *"underwriting."* All insurers have standards against which they gauge the acceptability of an application and the risk presented by the applicant, which are called "underwriting guidelines."

During the application process the insured and insurer initially define their respective expectations. For the insured, that is done by a description of material aspects the business operation and necessarily, attending risks. For the insurer, it is done by offering a *policy* at a stated premium, or denying the application. The formation of insurance policies generally follows the traditional offer-and-acceptance model of the common law. In most cases when an insuring relationship is created, it is based upon a fairly standardized policy; the same risk or risks are usually insured on about the same terms regardless of the insurer involved. However, when larger or more complex risks are involved, the policy may be specially fashioned for the insured. When that is done, the contract is usually called a "manuscript policy" and contains provisions that the parties have negotiated.

For more on the application process, see *Insurance Applications Process*.

Understanding the Insurance Policy

When the terms of a policy are proposed, or when one is delivered for examination, there can be many complex and fundamental questions that arise. You may be enlisted to interpret a proposed insurance contract and provide coverage analysis and advice. Some common questions include:

- Does the policy cover damage to the business property?
- Does it cover the range of liability to which a business such as mine could be liable?
- If a customer is injured as a result of the business activity or on the business property, will the insurance pay damages for which the client-business is found liable?
- Even if the kind of liability and damages is covered, does the client have to pay the claimant first subject to reimbursement by the insurer?
- Is cybersecurity coverage or similar coverage for hacking or computer glitches provided that causes damage to either third-parties, the client or both?
- What are the policy limits, and are they per person or per occurrence (there's a difference!)
- What are your client's duties in the event of a loss? Are there time limitations for compliance?

Common Types of Business Insurance

Commercial General Liability Insurance

One of the most important components of a business entity's insurance program is the coverage provided by *commercial general liability (CGL)* policies. These traditionally broad policies insure against the risk that the insured may cause injury to third parties. Accordingly, this type of insurance policy – protecting the insured against claims for damages brought by third persons or entities – is often described as providing "third-party coverage," in contrast to policies providing "first-party coverage," which cover damage to the insured's own property. See *Commercial Property Insurance*.

As with other insurance policies, there are two types of protection typically provided by CGL policies: indemnity (liability) coverage and defense coverage.

Indemnity or liability coverage pays a third party for injury or damage for which the insured is legally liable. Payment can be by way of settlement or after a finding of liability at trial. Keep in mind, however, that except in extraordinary circumstances, the insurer's obligation to pay is limited to the policy limits purchased.

Most all liability policies, including the CGL, furnish a defense for the insured. That means that the insurer appoints and pays an attorney (and court costs) to defend the insured in a lawsuit stemming from a covered *occurrence*. Prior to a suit being filed, the insurer will investigate the claim and may make a pre-suit offer to resolve it. Importantly, the insured is obliged to fully cooperate in the investigation and, if suit is filed, in the defense. In most situations, the insurer has the right to "control the defense" in the sense of deciding whether or not to settle the claim or go to trial, but the interest of the insured have to be paramount.

When suit is filed and defense counsel assigned, a "tripartite" relationship is created: the insured, the attorney defending the insured who is paid by the insurer, and the insurer itself. Ethical dilemmas can sometimes develop or it can be perceived that defense counsel is doing the bidding of the insurer. If that is your perception or that of your client, you can and should monitor the litigation. While the insurer does have the right to the direct the defense, there may be remedies available if a poor result for the insured can be traced to the insurer and/or defense counsel.

History and Development of the CGL

The *Insurance Services Office (ISO)* standard CGL form provides coverage for two categories of occurrences: (1) bodily injury and property damage and (2) personal and advertising injury. These coverages are discussed in further detail below.

The earliest standard CGL policy form, which was titled the Comprehensive General Liability Policy, was developed in 1940 by insurance industry organizations. The industry developed a standard form so that coverage terms and prices could be easily compared, to allow industry-wide loss statistics to be collected, and to enhance the consistency of judicial interpretation of policies. Since 1940 the standard form has undergone a number of significant revisions.

Before 1966, CGL policies generally covered injury or damage "caused by accident." In 1966, the policy form was broadened to cover "occurrences," which was defined as "an accident, including injurious exposure to conditions, which results, during the *policy period*, in bodily injury or property damage neither expected nor intended from the standpoint of the insured." In 1973, the CGL form was revised to exclude coverage for pollution, unless such pollution was "sudden and accidental."

The year 1986 saw several major revisions to the CGL form. First, the pollution exclusion was revised to eliminate the "sudden and accidental" exception and the policy added exclusions for asbestos and other types of toxic tort liability. The 1986 revision also offered two different coverage triggers: occurrence and "claims made," though the latter proved unpopular with policyholders and has not been widely adopted. See *Occurrence or Claims-Made Policies*. Finally, the form was renamed the Commercial General Liability Policy. The CGL form has been revised numerous times since 1986, most recently in April of 2013, but the core coverage provided has remained the same. The current standard CGL form is drafted by the ISO.

Because most CGL policies provide coverage on a "per occurrence" basis (i.e., they are triggered by the date of the claimant's injury rather than the date of the claim), older CGL policies may provide coverage for claims filed many years after the claimant's injury began. Accordingly, it is important to retain all CGL policies.

For more information, see *Commercial General Liability (CGL) Insurance* and *3 New Appleman on Insurance Law Library Edition § 16.01* (2018)

Commercial Property Insurance

For many commercial policyholders, their property – physical, tangible, and other, in whatever form the interest – is a valuable asset. Most large businesses typically purchase first-party property insurance policies, one of the oldest forms of commercially available insurance coverage They do so specifically to protect their property against fire, explosion, weather conditions, and other common perils. As discussed below, first-party property insurance comes in a wide variety of forms that have evolved over time, and becoming, in recent years, increasingly specialized and complex.

Commercial property insurance comes with specially designed underwriting and placement requirements. They are usually intended to provide the insurer with sufficient information by which to value the property and evaluate the risks that may threaten the property. In most standard property insurance policies it is those risks, known in the language of the policies as “perils,” that provide the fundamental basis for the grant of coverage. In other words, coverage often exists or not under the policy based on the specific inclusion in the grant of coverage of the loss-causing peril. If the peril causing the loss is not stated, there is no coverage. A proper understanding of these perils and how they are addressed within the policy is often critical in ensuring that the policyholder has the needed coverage.

For more information, see *Commercial Property Insurance* and *5 New Appleman on Insurance Law Library Edition § 41.01* (2018).

Umbrella and Excess Insurance

An excess policy provides specific coverage above an underlying limit of *primary insurance*. A true excess policy does not broaden the underlying coverage. While an excess policy increases the dollar amount of coverage available to compensate for a covered loss, it does not broaden the scope of coverage. Instead, it correlates coverage with the primary policy’s and provides an additional layer of protection for the insured. Because an excess insurer's duties to its insured are not triggered until the limits of the underlying primary policy (or policies) are exhausted within the meaning of the excess policy, courts sometimes refer to excess insurance as "secondary insurance," or "supplemental" or "supplementary insurance." Additionally, the first layer of coverage above an SIR is sometimes described as "excess insurance." When a policyholder is subject to a large claim and it appears that the limits of the underlying policy may be exhausted, it is not unusual for the excess insurer to hire counsel to monitor the litigation. In part, that is done to exert pressure on the primary insurer to settle the case within the limits of that policy (if the claimant will accept that amount) so that the excess policy is not invaded.

An umbrella policy is similar to an excess policy in that it protects the insured against liability for catastrophic losses that would exceed the limits of affordable primary coverage. An insured must maintain a specified amount of underlying primary coverage. However, an umbrella policy differs from an excess policy in a critical respect: an umbrella policy typically insures against certain risks that a concurrent primary policy does not cover. An umbrella policy is therefore, a ”gap filler"; by design it provides first dollar coverage where a primary policy and an excess policy do not. By dropping down to fill a gap in primary coverage, an umbrella policy broadens the insured's primary coverage whereas an excess policy merely provides additional liability coverage above the primary limits. The terms "excess policy" and "umbrella policy" are not synonymous, although an umbrella policy is much more like an excess policy than it is a primary liability insurance policy.

For more information, see *Umbrella and Excess Insurance Coverage* and *4 New Appleman on Insurance Law Library Edition § 24.01* (2018).

Errors & Omissions Liability Insurance

E&O coverage, as its name implies, covers errors or omissions made by a professional in the course of his or her practice. Representative types of insureds are doctors, lawyers, real estate professionals, accountants, engineers, and architects. The coverage is limited: it applies only to negligent acts or omissions made in the course of the professional’s practice. Coverage for other kinds of business risks, such as a client being injured on business property or liability arising out of business use of a car, are provided by other types of policies.

A notable feature of E&O policies is that they almost universally provide “claims-made” coverage. That is, they are triggered not by an “occurrence” during the policy period, but by the assertion of a claim during the policy period.

This means that events that occur before the policy is issued can be covered by the policy, if they are reported during the policy period.

With a claims-made policy, then, coverage is triggered if a claim is made against the insured during the policy period. Some policies – called "claims made and reported" policies – have an additional requirement. The claim must be not only made against the insured during the policy period, but it must also be reported to the insurer during the policy period.

For more information, see *Errors and Omissions (E&O) Liability Insurance* and *4 New Appleman on Insurance Law Library Edition § 25.01* (2018).

Directors & Officer (D&O) Insurance

Directors & Officers (D&O) insurance protects corporate directors and officers from lawsuits for activities connected with serving the corporation. By shielding corporate officers, it encourages outside individuals to serve as corporate directors.

Most D&O policies now provide coverage for both individual officers and directors, as well as Entity Coverage. Entity coverage insures the corporation against liability for its own wrongdoing or, more frequently, against vicarious liability for wrongdoing by its officers or directors.

Like E&O coverage, D&O policies are written on a "claims-made" basis. Coverage is triggered not by when a wrongful act occurs, but when a covered claim is asserted against the director, officer, or entity. E&O policies also can be written on claims-made and reported forms. Under such a form, a claim must not only be made during the policy period, but also reported during the policy period.

For more information, see *Director and Officer (D&O) Insurance* and *4 New Appleman on Insurance Law Library Edition § 26.01* (2018).

Cybersecurity Insurance

Cybersecurity coverage is a specialty insurance product intended to cover the costs and liabilities incurred because of breaches in computer and network security systems. The coverage provided under such policies addresses a diverse array of scenarios, which have in common only that they relate to problems with computers and computer networks. These insurance products have been developed relatively recently to address what seem to be increasingly frequent and well-publicized incidents of breaches of corporate computer networks, sometimes resulting in substantial harm to customers and to the insured's business. Companies dealing with large volumes of sensitive data, such as financial, health care, or retail companies, may face particularly significant exposure to the risks addressed by cybersecurity policies.

Sometimes cybersecurity coverage is sold as part of a business risk package that also includes general liability and other coverage. More frequently, however, it is sold as stand-alone coverage focused on computer-based risks.

Part of the increase in availability of cybersecurity insurance has been prompted by new regulations issued by the SEC requiring some reporting companies to specify in securities disclosures the steps that they have taken in reference to cybersecurity, including whether they have insurance.

For more information, see *Cybersecurity Insurance* and *4 New Appleman on Insurance Law Library Edition § 29.01* (2018).

Fidelity Insurance

Fidelity/Fiduciary Liability Insurance covers legal liability arising from claims for errors and omissions in managing or administering an employee benefit or pension plan. Typically, the "insured" is defined as a trust or employee benefit plan; any trustee, officer or employee of the trust or employee benefit plan; and any other individual or organization designated as a fiduciary. In addition to pension and retirement plans, group life and medical expense plans may also be covered under such a policy.

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In addition to plan administrators, the employer and even the plan itself can be the targets of lawsuits. As a result, Fiduciary Liability policies can provide substantial benefits to entities and pension plan administrators.

For more information, see *Fidelity Insurance* and *10 New Appleman on Insurance Law Library Edition § 111.01* (2018).

Related Content

Practice Notes

- *Business Insurance Policies Review*
- *Business Insurance Policies Interpretation*
- *Policy Content and Other Form Requirements*
- *Commercial Property Insurance*
- *Commercial Property and Liability Insurance*
- *Occurrence or Claims-Made Policies*
- *Commercial General Liability (CGL) Insurance*
- *Umbrella and Excess Insurance Coverage*
- *Errors and Omissions (E&O) Liability Insurance*
- *Director and Officer (D&O) Insurance*
- *Cybersecurity Insurance*
- *Fidelity Insurance*
- *Endorsements, Exclusions, Exemptions, and Conditions*
- *Insurance Applications Process*
- *Insurance Industry Guide for Capital Markets*

Annotated Forms

- *Director's and Officer's (D&O) Liability Insurance Policy*
- *Employment Practices Liability (EPL) Insurance Policy*

- *Fiduciary Liability Insurance Policy*
- *ISO Form CG 00 02 01 96 (Commercial General Liability Coverage Form) (Occurrence)*
- *ISO Form CG 00 02 07 98 (Commercial General Liability Coverage Form) (Claims-Made)*
- *ISO Form CP 00 99 06 07 (Commercial Property - Standard Property Policy)*

Checklists

- *Property Insurance Claim Filing Checklist*
- *Endorsements, Exclusions, Exemptions, and Conditions Checklist*
- *Fidelity Insurance Policy Review Checklist*
- *Policy Content and Other Form Requirements Checklist*
- *Cybersecurity Insurance Policies Review Checklist*

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