PAGEL, DAVIS & HILL, P.C. ***BUSINESS INSIGHTS***

Business Lawyers First

FIRST PARTY AND THIRD PARTY INSURANCE POLICIES COMPARED

In this *Business Insights* issue, we will give specific examples of insurance policies that are commonly held by businesses and are either first party insurance or third party insurance type policies. These types of insurance policies are commonly referred to in the insurance industry as commercial lines of coverage.

A commercial property insurance policy covers losses of personal property and real property owned by the insured. Personal property includes equipment, inventory and finished goods. Finished goods in transit would also be covered under the commercial property insurance policy. Real property would include buildings and improvements. A common type claim that would result in coverage under a commercial property insurance policy may be a fire, flood, or theft.

Commercial property insurance, which is first party insurance, is basic coverage that virtually all businesses carry. Few businesses could survive the loss of all or even a significant percentage of their personal property or real property without being compensated for that loss. Furthermore, banks are not inclined to loan money against personal property, real property or both unless property insurance is in place and the bank is named a loss payee on such policy. As loss payee the bank would be entitled to make a direct claim against the commercial property insurance proceeds in the event of a loss to property which serves as the bank's collateral.

Fire coverage is fairly well standardized throughout the U.S. and serves as the building block upon which commercial property insurance is constructed. An example of such coverage is seen in this Case Break.

> CASE BREAK:
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> A fire breaks out at a manufacturing facility. The fire was caused by a lightning storm. The fire damages most of the plant and essentially shuts down operations for the better part of 6 months. The replacement of the buildings and improvements, as well as the equipment, inventory and finished goods, is covered by commercial property insurance purchased by the company that owns the plant. The company is the first party and the insurance carrier is the second party. If a bank has loaned money to the plant owner, the insurance proceeds will be paid to the bank to the extent of the loan amount assuming the bank has been named loss payee under the commercial insurance policy.

In addition to commercial property insurance, another common commercial lines policy is commercial general liability Insurance, which is also commonly referred to as CGL insurance. This type of third party insurance covers the insured against losses sustained by third parties arising out of the insured's business operations or products. The types of losses that are covered may include either property damage and/or bodily injury. The terms property damage and bodily injury have specific meanings as they are used in commercial lines policies.

Commercial general liability insurance is quite broad coverage. There are however a number of important exclusions and endorsements which in turn limit the coverage.

Let's look at an example of a claim that would be covered by a retailer's commercial general liability policy:

> CASE BREAK:
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> A visitor to a retail establishment slips and falls in front of the building and sustains a broken arm. He files a lawsuit and claims negligence on the part of the retailer in failing to provide a safe entrance to visitors to the business. The lawsuit would be defended and the bodily injury covered under the retailer's commercial general liability insurance policy.

Another common commercial lines policy that is commonly owned by businesses is commercial automobile insurance. Commercial automobile insurance generally provides first party coverage, which is damage to the insured's vehicles themselves, and losses sustained by third parties arising out of the insured's operation of its vehicles. The first party coverage part regarding losses to the insured's vehicles is also referred to as collision coverage. The third party coverage part would include losses caused to vehicles or personal property owned by third parties and bodily injury sustained by third parties resulting from the operation of the insured's vehicles.

Let's look at an example of a claim that would be covered by a company's commercial automobile insurance policy.

CASE BREAK:

A company truck driver runs a red light and strikes a passenger vehicle. The driver of the passenger vehicle is injured and her car is damaged. Negligence is asserted by the injured driver's attorney in the lawsuit that is filed. Both property damage and bodily injury is asserted. The lawsuit would be defended and the property damages and bodily injury covered under the commercial automobile policy.

Insurance limits exist with respect to both CGL and commercial automobile insurance policies. A common limit for a CGL policy is $1,000,000 per occurrence or a $2,000,000 aggregate. To effectively increase the limits under the CGL and commercial automobile insurance policies, an excess Insurance policy can be purchased. Excess Insurance is an insurance policy that covers the insured in excess of the stated limits of the underlying policy—which is referred to as the Primary Policy. Examples of a primary policy are the CGL and a commercial automobile insurance policy.

Here is an example of how excess insurance works:

CASE BREAK:

A company's CGL policy provides a limit of $1,000,000 per occurrence. A claim is asserted by a claimant that far exceeds the $1,000,000 amount. If the ultimate claim amount is less than $1,000,000, and assuming the claim is covered by insurance, the CGL policy will pay the full amount of the claim. If the ultimate claim amount is greater than $1,000,000, if there is excess insurance the excess insurance policy will pay the claim amount greater than $1,000,000 to the extent of the limits of the excess insurance policy. If there is no excess insurance policy and the claim amount is greater than $1,000,000, the company will need to pay this amount of its own assets.

Another common commercial lines policy is workers compensation insurance. Workers compensation insurance, which is third party insurance, is mandated in almost every state—and pays for medical expenses incurred and lost wages due to an accident sustained by a company employee. To be covered the accident must occur during the employee's course and scope of employment. Workers compensation coverage enables companies to provide for medical expense coverage and lost wages for its employees and bars those injured employees from pursuing a lawsuit against the company for such losses. This inability on the part of the employee to sue his or her employer for workplace injuries is commonly referred to as the workers compensation bar.

There are many other less common commercial lines policies that may be carried by a business. As they do provide important insurance coverage we will mention them briefly.

Dishonesty and Embezzlement Insurance, which is first party insurance, provides coverage against loss arising from burglary, robbery or theft. Dishonesty and Embezzlement insurance policies take many forms. Embezzlement is often covered under a Blanket Crime Policy which includes dishonesty of employees insurance as well.

Business Interruption Insurance, a form of property insurance and thus is first party insurance, provides coverage against a loss of earnings by the insured resulting from a partial or complete shutdown of operations. There must be an accidental damage to property and that property must produce earnings to the insured.

Errors or Omissions Insurance also known as Professional Liability Insurance is third party insurance that protects a professional insured against liability for committing an error or omission in performance of professional duties. In the construction industry, errors or omissions insurance is commonly obtained by architects and engineers. It is generally designed to cover financial losses rather than liability for bodily injury and property damage.

Directors and Officers Liability Insurance provides third party insurance coverage for directors' and officers' liability exposure if they are sued as individuals. Most likely the claims will be asserted by stockholders and employees alleging financial loss from mismanagement.

Employment Practices Liability Insurance is third party insurance coverage that protects the insured from litigation of a claim arising out of the employment process. The most frequent types of claims alleged under such policies include wrongful termination, discrimination and sexual harassment.