Direct Your Learning

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Loss Exposures

Educational Objectives

After learning the content of this assignment, you should be able to:

- Describe property loss exposures in terms of assets exposed to loss, causes of loss, financial consequences of loss, and parties affected by loss.
- Explain how legal liability to pay damages can be based on torts, contracts, or statutes.
- Describe liability loss exposures in terms of assets exposed to loss, causes of loss, and financial consequences of loss.
- Describe personnel loss exposures in terms of assets exposed to loss, causes of loss, and financial consequences of loss.
- Describe net income loss exposures in terms of assets exposed to loss, causes of loss, and financial consequences of loss.

Outline

Loss Exposures

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PROPERTY LOSS EXPOSURES

The elements of a property loss exposure are important to an insurance professional because they provide a framework for analyzing loss exposures that may be handled through appropriate risk management techniques.

There are three important elements of property loss exposures:

- Assets exposed to property loss—The types of property that may be exposed to loss, damage, or destruction.
- Causes of loss—Those that may result in property being lost, damaged, or destroyed.
- Financial consequences—Those consequences that may result from a property loss. A property loss can be the cause of a net income loss; however, that is considered a separate loss exposure.

In addition to describing these elements of property loss exposures, this section discusses the parties who may be affected when property is lost, damaged, or destroyed.

Assets Exposed to Property Loss

An asset is property, which is any item with value. Individuals, families, and businesses own and use property, depend on it as a source of income or services, and rely on its value. Property can decline in value—or even become worthless—if it is lost, damaged, or destroyed. Different kinds of property have different qualities that affect the owner's or user's exposure to loss.

Two basic types of property are real property and personal property. Insurance practitioners further divide these kinds of property into several categories:

- Buildings
- Personal property contained in buildings
- Money and securities
- Vehicles and watercraft
- Property in transit

These categories overlap to some extent. For example, vehicles, when carried on trucks, can be property in transit. These categories are listed separately here because they represent types of property for which specific forms of insurance have been developed.

Buildings

Buildings are more than bricks and mortar. Most buildings also contain plumbing, wiring, and heating and air conditioning equipment, which can lead to leaks, electrical fires, and explosions. Most buildings also contain basic portable equipment, such as fire extinguishers and lawn mowers, that is required to service the building and surrounding land. Under most insurance policies, such equipment is considered part of the building. Property that is permanently attached to the structure, such as wall-to-wall carpeting, built-in appliances, or boilers and machinery, is generally considered part of the building as well.

Fixture

Any personal property affixed to real property in such a way as to become part of the real property.

Boilers and machinery constitute a special class of property. They are often affixed to a building in such a manner that they become a permanent part of the building and are considered to be **fixtures**. This class of property includes any of these types of equipment:

- Steam boilers (large water tanks heated by burning gas, oil, or coal to produce steam for heating or to produce power)
- Unfired pressure vessels, such as air tanks
- Refrigerating and air conditioning systems
- Mechanical equipment, such as compressors and turbines
- Production equipment
- Electrical equipment

Boilers and machinery share these two characteristics:

- They are susceptible to explosion or breakdown that can result in serious losses to the unit and to persons and property nearby.
- They are less likely to have explosions or breakdowns if they are periodically inspected and properly maintained.

Personal Property Contained in Buildings

The contents of a typical home include personal property such as furniture, clothing, electronic equipment, jewelry, paintings, and other personal possessions. The contents of a commercial building may include these items:

- Furniture, such as desks or file cabinets in an office
- Machinery and equipment, such as cash registers in a supermarket
- Stock, such as groceries in a store

Although most policies use the term "personal property" (which is all property other than land and property attached to the land, such as buildings) to refer to the contents of a building, many insurance practitioners and policyholders use the term "contents" as a matter of convenience and common practice. Property insurance policies refer to personal property, rather than contents, because the property is often covered even when it is not literally contained in the building. When the contents of a commercial building are involved, policies generally use the term "business personal property."

Money and Securities

For insurance purposes, money and securities are separate from other types of contents because their characteristics present special problems. **Money** and **securities** are highly susceptible to loss by theft. Cash is particularly difficult to trace because it can be readily spent. In contrast, other types of property must be sold for cash before the thief can make a profit. Money and securities are also lightweight, easily concealed, and easy to transport.

In addition to being susceptible to theft, money and securities can be quickly destroyed in the event of a fire. For example, unless a store owner makes a bank deposit every night after the store closes, the store owner could lose a considerable amount of currency and checks in a fire.

Money

Currency, coins, bank notes, and sometimes traveler's checks, credit card slips, and money orders held for sale to the public.

Securities

Written instruments representing either money or other property, such as stocks and bonds.

Vehicles and Watercraft

The primary purpose of most vehicles and watercraft is to move people or property, and this movement exposes vehicles and watercraft to several causes of loss. Vehicles may be grouped by vehicle type, by operator type, by typical usage, or by a combination of these characteristics. No matter which classifications are used, some vehicles (such as snowmobiles or utility vehicles) fit into more than one category, depending on the purpose for which they are owned and used. However, these categories are useful in identifying property loss exposures:

- Autos and other highway vehicles
- Mobile equipment
- Recreational vehicles

In insurance terminology, the word "**auto**" can also include such diverse vehicles as fire engines, ambulances, motorcycles, and camping trailers. **Mobile equipment** may be damaged in a highway collision, but the most frequent exposures to loss involve off-road situations. In some cases, the owners of **recreational vehicles** face exposures to loss both on and off the road.

Watercraft are exposed to special perils not encountered in other means of transit. Those perils include extreme weather conditions that can create rougher seas than the craft can handle; poor navigation, resulting in striking the ground or another obstacle; and, depending on the shipping route, piracy.

Auto

As defined in commercial general liability and auto forms, a land motor vehicle, trailer or semitrailer designed for travel on public roads, including attached machinery or equipment; or any other land vehicle that is subject to a compulsory or financial responsibility law or other motor vehicle insurance law in the state where it is licensed or principally garaged.

Mobile equipment

Various types of vehicles designed for use principally off public roads, such as bulldozers and cranes.

Recreational vehicle

A vehicle used for sports and recreational activities, such as a dune buggy, all-terrain vehicle, or dirt bike.

Property in Transit

A great deal of property is transported by truck, but property is also moved in cars, buses, trains, airplanes, and watercraft. When a conveyance containing cargo overturns or is involved in a collision, the cargo can also be damaged. In addition, cargo can be destroyed without damage to the transporting vehicle or watercraft. Liquids can leak out, fragile articles can be jostled during transit, and perishables can melt or spoil.

When property is damaged or lost in transit, it must be replaced. Delays often result, because replacement property may have to be shipped from the location of the original shipment. The property owner may also incur expense to move damaged property.

Property being transported by watercraft could be lost entirely if the watercraft were to sink. Even more so than other property, ocean cargoes fluctuate in value according to their location. If the watercraft cannot reach its intended destination and the cargo must be sold in a different port, the price received for the cargo might be less than the price expected at the original destination.

Causes of Property Loss

Peril

The cause of a loss.

Causes of loss (or **perils**) include fire, lightning, windstorm, hail, and theft. Most causes of loss adversely affect property and leave it in an altered state. A fire can reduce a building to a heap of rubble. A collision can change a car into twisted scrap. Some causes of loss do not alter the property itself, but they affect a person's ability to possess or use the property. For example, property lost or stolen can still be usable, but not by its rightful owner.

The terms "peril" and "hazard" are often confused. As stated, a peril is a cause of loss. Fire, theft, collision, and flood are examples of perils that cause property losses. (Many property insurance policies use the term "cause of loss" instead of peril.)

A hazard is anything that increases the frequency or the severity of a loss. These are two examples:

- Careless smoking practices are a fire hazard because they increase the frequency of fires.
- Keeping large amounts of money in a cash register overnight is a theft hazard affecting both the frequency and the severity of loss.

Financial Consequences of Property Losses

When a property loss occurs, the property is reduced in value. The reduction in value can be measured in different ways, sometimes with differing results. If the property can be repaired or restored, the reduction in value can be measured by the cost of the repair or the restoration. Property that must be replaced has no remaining worth, unless some salvageable items can be sold. Consider these examples:

- A fence worth $7,000 was damaged by a car, and the fence owner has to pay $2,000 to have the damage repaired. The fence owner has incurred a partial loss that reduced the fence's value by $2,000.
- A camera worth $400 is run over by a truck. The camera owner has incurred a total loss that reduced the camera's value by $400.

If property is lost, is stolen, or otherwise disappears, its value to the owner is reduced just as though it had been destroyed and retained no salvage value. A further reduction in value might occur if repaired property is worth less than it would have been if it had never been damaged. This is true for items such as fine paintings and other art objects. Many collectibles are valuable largely because they are in mint or original condition. An object that has been repaired after damage from a tear, a scratch, or fire is no longer in that unspoiled condition, and its value will decline. The owner faces loss in the form of the cost to repair the object, as well as a reduction in value because of the altered condition.

Property may have different values, depending on the method by which the value is determined. The most common valuation measures used in insurance policies are replacement cost and actual cash value (ACV). In certain situations, however, other valuation measures are used, such as agreed value.

Parties Affected by Property Losses

Parties that may be affected by a property loss include these:

- Property owners
- Secured lenders of money to the property owner
- Property holders

Property Owners

The party that is affected most when property is lost, damaged, or destroyed is usually the owner of the property. If the property has some value, the owner of the property incurs a financial loss to repair or replace it. In a supermarket fire, for example, the store's owner could incur a considerable financial loss because it had to rebuild the store and restock the shelves.

Secured Lenders

When money is borrowed to finance the purchase of a car, the lender usually acquires some conditional rights to the car, such as the right to repossess the car if the car's owner (the borrower) fails to make loan payments. This right gives the lender security. Such a lender is therefore called a secured lender or a secured creditor. When a person or business borrows money to buy a home or a building and the property serves as security for the loan, the secured

Mortgagee

A lender in a mortgage arrangement, such as a bank or another financing institution.

Mortgagor

The person or organization that borrows money from a mortgagee to finance the purchase of real property.

lender is called a **mortgagee**(or mortgageholder), and the borrower is called a **mortgagor**.

When property is used to secure a loan, the lender is exposed to loss. Returning to the supermarket fire example, if the store owner had a mortgage on its supermarket building, the mortgagee would lose the security for the mortgage loan if the building burned. Similarly, if a financed car is destroyed in an accident, no vehicle would be available for the lender to repossess in the event that the owner defaulted on the loan. Property insurance policies generally protect the secured lender's interest in the financed property by naming the lender on the insurance policy and by giving the lender certain rights under the policy.

Property Holders

Bailee

The party temporarily possessing the personal property in a bailment.

Bailees are responsible for safekeeping property they do not own. Dry cleaners, repair shops, common carriers, and many other businesses temporarily hold property belonging to others. To estimate its property loss exposures, such a business has to consider not only its own property, but also the property held for others.

Apply Your Knowledge

Sam rents retail space in a strip mall, in which he operates a florist shop. His employees make deliveries with two vans owned by the shop. How should an insurance professional analyze each of the three elements of the florist shop's property loss exposures?

Feedback:

- Assets exposed to property loss—Sam has exposure in each of the property types, except for a building. Because he rents the retail space from which his store operates, he does not have the exposure of a building being damaged. However, he does have personal property contained in the rented space of the building. Specifically, he is likely to have equipment to run his business, such as refrigerated display cabinets, telephones, file cabinets, computer equipment, a cash register, and an inventory of flowers and the tools and supplies to arrange and display them. Sam also has exposure with money and securities, as he collects payments from customers. He has exposure related to the vehicles used to deliver flowers as well. The vehicles have a high value and could be expensive to repair or replace. Finally, he has exposure connected to property in transit. The flowers are valuable inventory, and if they are damaged in transit to a customer, Sam will probably have to replace them at his expense.
- Causes of loss—Some of the perils include fire, theft, and collision. Fire could damage or destroy all the types of property at the store or in a van. Theft could also involve all of the individual types of property, including money and securities in particular, personal property in the building, vehicles, and property in transit. Another peril is collision of a van with

another object, which could damage both the vehicle and the property in transit in the same accident.

- Financial consequences—Each type of property, if damaged or destroyed, could incur a reduction in value. If property is damaged, the cost to repair or restore it is often the amount of reduction in value. For example, if Sam's van were involved in a collision while making a delivery, it may be possible to have it repaired for a cost that is less than the value of the van; therefore, it would not be a total loss. The value of the van after the collision would be reduced until repairs were completed. The flower arrangements in the van at the time of the collision may be difficult to repair. Consequently, it may be more cost effective to consider them destroyed and replace them. The damaged flowers would have lost all value.

THE BASIS FOR LEGAL LIABILITY

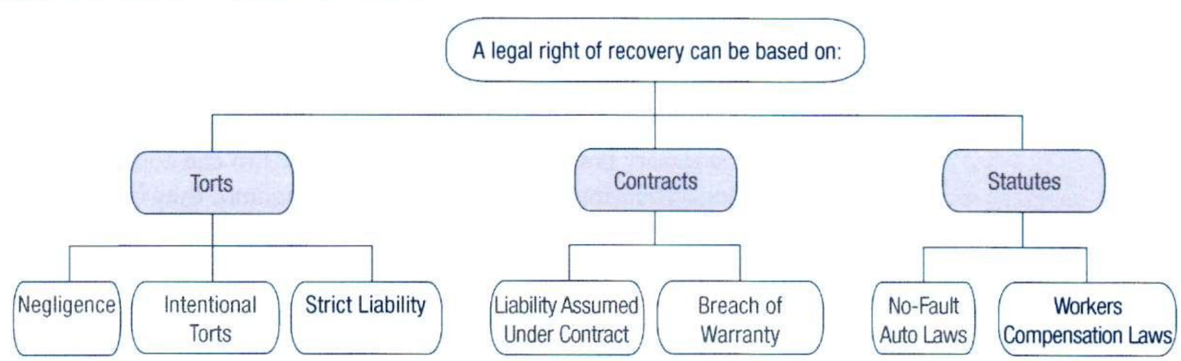
An understanding of legal liability is essential to recognizing liability loss exposures. Although complex legal questions require the professional expertise of an attorney, knowledge of some fundamental legal terms and concepts is essential for anyone dealing with liability loss exposures or liability insurance.

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.

Legal liability can arise based on torts, contracts, and statutes. Before examining torts, contracts, and statutes, it is necessary to understand these legal foundations: the general sources of law, the distinction between civil and criminal law, and the concept of damages. See the exhibit "Legal Basis of a Liability Claim."

Legal Basis of a Liability Claim



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Legal Foundations

Laws exist in a civilized society to enforce certain standards of conduct. Laws generally require conduct that makes the world safer and more secure. Laws accomplish this objective by holding people responsible for their actions. The legal foundations of sources of law, criminal law, civil law, and damages explain, in part, how laws enforce responsibility.

Sources of Law

The legal system in the United States derives essentially from the Constitution, which is the source of constitutional law; legislative bodies, which are the source of statutory law; and court decisions, which are the source of common law.

The Constitution is the supreme law in the U.S., and it outlines the respective powers of its legislative, executive, and judicial branches. With its amendments, the Constitution guarantees to all citizens certain fundamental rights, such as freedom of speech and freedom from unreasonable searches and seizure. All other laws must conform to **constitutional law**. The courts interpret the Constitution to decide constitutional issues. If the U.S. Supreme Court decides that a particular law conflicts with the Constitution, that law is invalidated. Each state also has a constitution and some type of supreme court to hear appeals on matters of state law. States must ultimately follow the U.S. Constitution.

Constitutional law

The Constitution itself and all the decisions of the Supreme Court that involve the Constitution.

National, state, and local legislatures enact **statutes** to deal with perceived problems. At the national level, any member of the U.S. Senate or House of Representatives may introduce a bill. If the bill receives a majority vote in both the Senate and the House and the president signs it, the bill becomes law. State legislatures also make new laws in similar fashion. Laws made by local governments are often called ordinances. Collectively, these formal enactments are referred to as **statutory law**.

Statute

A written law passed by a legislative body, at either the federal or state level.

Statutory law

The formal laws, or statutes, enacted by federal, state, or local legislative bodies.

Some federal, state, and local government agencies have regulatory powers derived from authority granted by legislative bodies. These regulatory agencies issue detailed rules and regulations covering a particular public concern. They also render decisions on the application of these rules and regulations in certain cases.

In contrast to statutory law, common law has evolved in the courts. When the king's judges began hearing disputes in medieval England, they had little basis for their decisions except common sense. However, each decision became a precedent for similar cases that followed it. Gradually, certain principles evolved over time that became known as **common law (case law)**. These common-law principles guided judges in the English colonies in America as well. When neither constitutional nor statutory law applies, judges still rely on precedents of previous cases to reach their decisions.

Common law (case law)

Laws that develop out of court decisions in particular cases and establish precedents for future cases.

Criminal Law and Civil Law

The U.S. legal system makes an important distinction between criminal law and civil law. Legal cases related to insurance usually involve civil law.

Criminal law applies to wrongful acts that society deems so harmful to the public welfare that the government takes the responsibility for prosecuting and punishing the wrongdoers. For example, criminal laws prohibit robbery, arson, and driving while intoxicated. Crimes are punishable by fines, imprisonment, or, in some states, death. When a crime occurs, the police investigate and, if sufficient evidence is found, criminal charges are brought on behalf of the state against the accused wrongdoer.

Criminal law

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

Civil law deals with the rights and responsibilities of citizens with respect to one another. Civil law proceedings provide a forum for hearing disputes between private parties and rendering a decision binding on all parties. This procedure enables individuals to protect themselves against infringement of their rights by others. Civil law also protects contract rights. People and businesses are more willing to make agreements or contracts with one another when they know that the contracts will be enforceable. If a party does not honor its contract with another party, the other party can ask the court to enforce compliance or assess damages.

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.

An act can have both criminal and civil law consequences. For example, Carole was returning from a business trip when her car was broadsided by another vehicle. Beyond the damage to her car, her injuries required medical care costing thousands of dollars, and she missed two weeks of work. Following the accident investigation, the other driver was criminally charged and convicted of driving while intoxicated. Carole's auto insurer paid most of her medical and auto physical damage bills. However, she also brought a civil suit against the other driver for her lost wages. Based on the merits of the case, the jury decided in her favor, and the court ordered the other driver to pay an amount equal to the income she had lost.

Damages

A person must sustain actual harm for a liability loss to result in a valid claim. For example, passengers injured in an auto accident can collect damages from the driver only if they can prove they actually suffered some harm as a result of the driver's actions. Perhaps they had to be treated in the hospital emergency room, their clothing was ruined, or they could not go to their jobs and thus lost a day's pay. To those who can show that actual harm or injury was suffered because of the driver's actions, the court may award damages that the driver will have to pay.

There are two main categories of damages: compensatory damages and punitive damages. Compensatory damages are intended to compensate the victim for the harm actually suffered. An award of compensatory damages is the amount of money that has been judged to equal the victim's loss, and it is the amount the party responsible for the loss will have to pay. Compensatory damages include both special damages and general damages. In addition, the court could award punitive damages (exemplary damages).

Torts

Tort

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

Tort law

The branch of civil law that deals with civil wrongs other than breaches of contract.

A **tort** is any wrongful act, other than a crime or breach of contract, committed by one party against another. Crimes differ from torts, because criminal law allows the state to prosecute and civil law does not. Tort law is enforced by the injured party bringing a private lawsuit against the alleged wrongdoer. The central concern of **tort law**, which deals with civil wrongs other than breaches of contract, is determining responsibility for injury or damage. Although largely modified or restated in statutes, tort law is still based mainly on common law.

A person who is legally responsible for an injury may be compelled to compensate the victim only if there is some standard for assigning that responsibility. Under tort law, an individual or organization can face a claim for legal liability on the basis of negligence, intentional torts, or strict liability. See the exhibit "Types of Torts."

Types of Torts

	Description	Element(s)	Examples
Negligence	Failure to act in a prudent manner	• Duty owed to another • Breach of that duty • Breach of duty is proximate cause of injury or damage • Injury or damage	• Driving while intoxicated and causing an accident • Allowing a pet dog to run loose and bite a child
Intentional Torts	Deliberate acts that cause harm	Deliberate act (other than a breach of contract) that causes harm to another person	• Assault • Battery • Libel • Slander • False arrest • Invasion of privacy
Strict Liability	Inherently dangerous activities	Inherently dangerous activities or dangerously defective products that result in injury or harm	• Owning a wild animal • Blasting operations

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Negligence

Negligence occurs when a person or an organization fails to exercise the level of care that a reasonably prudent person would have exercised under similar circumstances. The greatest number of liability cases arise from negligence. Tort law gives injured parties the right to seek compensation if they can demonstrate that someone else's negligence led to their injuries. The party seeking compensation is referred to as the plaintiff, and the party from whom the plaintiff is seeking damages is referred to as the defendant.

Negligence

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

A liability judgment based on negligence requires proof of four elements. If any one of these elements is missing, the plaintiff cannot prove that the defendant was negligent:

- The defendant owed a legal duty of care to the plaintiff—The first element of negligence is that a person or an organization must have a duty to act (or not to act) that constitutes a responsibility to another party. For example, the driver of a car has a duty to operate the car safely.
- The defendant breached the duty of care owed to the plaintiff—A breach of duty is the failure to exercise a reasonable degree of care expected in a particular situation. For example, if a tank explodes, the fact that a storage tank had been filled beyond its listed capacity could indicate that a defendant failed to act reasonably and breached its duty to provide safe conditions.
- The defendant's negligent act was the **proximate cause** of the plaintiff's injury or damage—A finding of negligence also requires that the breach of duty initiate an unbroken chain of events leading to the injury. The breach of the duty must be the proximate cause of the injury. For example, patrons of a night club were injured by other patrons' panicking when part of a stage caught fire. The injured patrons would have to prove that the club owner's breach of its duty to provide safe conditions was the proximate cause of their injuries.
- The plaintiff suffered actual injury or damage—The fourth element of negligence requires that the claimant must suffer definite injury or harm. For example, passengers may claim a driver negligently caused an accident, but unless they actually suffered an injury, such as medical expenses, lost wages, or pain and suffering, they will not have a valid claim.

Proximate cause

A cause that, in a natural and continuous sequence unbroken by any new and independent cause, produces an event and without which the event would not have happened.

A person or an organization whose conduct is proved to be negligent is generally responsible for the consequences. This party is called the **tortfeasor**, the wrongdoer, or the negligent party. All of these terms refer to a party who does something that a reasonable person would not do (or fails to do something that a reasonable person would do) under similar circumstances.

Tortfeasor

A person or organization that has committed a tort.

In addition to the person who actually commits the act, other persons or organizations may be held responsible for the tortfeasor's action. This responsibility is called **vicarious liability**. Vicarious liability often arises in business situations from the relationship between employer and employee. An employee performing work-related activities is generally acting on behalf of

Vicarious liability

A legal responsibility that occurs when one party is held liable for the actions of a subordinate or associate because of the relationship between the two parties.

the employer. Therefore, the employer can be vicariously liable for the actions of the employee. If, for example, an employee drives a customer to a meeting and negligently causes an accident in which the customer is injured, both the employee and the employer could be held liable for the customer's injuries. Responsibility would not shift from the employee to the employer but rather could extend to include the employer.

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.

Assault

The threat of force against another person that creates a well-founded fear of imminent harmful or offensive contact.

Battery

Intentional harmful or offensive physical contact with another person without legal justification.

Defamation

A false written or oral statement that harms another's reputation.

Slander

A defamatory statement expressed by speech.

Libel

A defamatory statement expressed in a writing.

False arrest

The seizure or forcible restraint of a person without legal authority.

Invasion of privacy

An encroachment on another person's right to be left alone.

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.

Intentional Torts

An **intentional tort** is a deliberate act (other than a breach of contract) that causes harm to another person, regardless of whether the harm is intended. Assault and battery are common examples of intentional torts. **Assault** is an intentional threat of bodily harm under circumstances that create a fear of imminent harm. **Battery** is any unlawful and unprivileged touching of another person.

Another common example of an intentional tort is defamation. **Defamation** includes both slander and libel. **Slander** is a spoken, untrue statement about another person. **Libel** most often occurs when someone prints and distributes an untrue statement about another person that damages the person's reputation. However, libel can take place through any medium, such as radio, television, film, or the Internet. As a rule, the law affords public figures less protection against libel and slander than ordinary persons except when a false statement is also malicious. For defamation to occur, someone other than the defamed person must read or hear the false statement. Moreover, true statements are not defamatory.

The intentional tort of **false arrest** presents a potential problem for retail stores. False arrest can occur when a store employee detains a customer suspected of shoplifting. If it is later determined that the customer had not stolen any merchandise, the detainment is a false arrest that inconveniences and embarrasses the customer.

Liability for the intentional tort of **invasion of privacy** can arise from the unauthorized release of confidential information, the illegal use of hidden microphones or other surveillance equipment, an unauthorized search, or the public disclosure of private facts.

Strict Liability

Strict liability (absolute liability) is the legal liability arising from inherently dangerous activities or dangerously defective products that result in injury or harm to another, regardless of how much care was used in the activity.

Although most liability cases arise from negligence and some arise from intentional torts, liability under tort law is not entirely limited to cases of injury caused by negligent or deliberate conduct. In situations involving inherently dangerous activities, tort law can give an injured person a right of recovery without having to prove negligence or intent. Such inherently dangerous activities can give rise to strict liability for any injury regardless of the intent or the carefulness of the person held liable. The situation itself, rather than the person's conduct, becomes the standard for determining liability.

For example, the owner of a wild animal is liable for any injury the animal inflicts, regardless of the precautions the owner may have taken. Blasting operations present an exposure to strict liability for businesses. The mere fact that the business conducts blasting operations is enough to make the owners of the business liable for any injuries or damage that results.

Contracts

Contract law enables an injured party to seek recovery because another party has breached a duty voluntarily accepted in a contract. A contract is a legally enforceable agreement between two or more parties. If one party fails to honor the contract, the other may sue to enforce it. In such a case, it is the specific contract, rather than the law in general, that the court interprets. Two areas of contract law that are often the basis of legal liability for bodily injury or property damage to another are liability assumed under contract and breach of warranty.

Parties to a contract sometimes find it convenient for one party to assume the financial consequences of certain types of liability faced by the other. For example, the owner of a building and a contractor make a contract in which the contractor accepts responsibility for certain actions of a subcontractor. If one of the specified actions of the subcontractor injures a customer and the customer sues the owner, then the contractor will pay any damages owed to the customer because of the subcontractor's action. Such arrangements, called **hold-harmless agreements**, are common in construction and service businesses. They are called hold-harmless agreements because they require one party to "hold harmless and indemnify" the other party against liability specified in the contract.

Hold-harmless agreement (or indemnity agreement)
A contractual provision that obligates one of the parties to assume the legal liability of another party.

The law of contracts also governs claims arising from breach of warranty. Contracts for sales of goods include **warranties**, or promises made by the seller. The law also implies certain warranties. A seller warrants, for example, that an item is fit for a particular purpose. If Juanita buys the hair conditioner recommended and sold by her beautician, she relies on the warranty that the conditioner will be good for her hair. If the conditioner damages her hair instead, the beautician (as well as the manufacturer) could be held liable for a breach of warranty. The buyer does not have to prove negligence on the part of the seller. The fact that the product did not work shows that the contract was not fulfilled.

Warranty
A written or oral statement in a contract that certain facts are true.

Statutes

Statutory liability is legal liability imposed by a statutory law. Although common law may cover a particular situation, statutory law may extend,

Statutory liability
Legal liability imposed by a specific statute or law.

restrict, or clarify the rights of injured parties in that situation. One reason for such legislation is to ensure adequate compensation for injuries without lengthy disputes over who is at fault. Examples of this kind of statutory liability involve no-fault auto laws and workers compensation laws. In these legal areas, a specific statute (rather than the common-law principles of torts) gives one party the right of recovery from another or restricts that right of recovery.

To reduce the number of lawsuits resulting from auto accidents, some states have enacted "no-fault" laws. These laws recognize the inevitability of auto accidents and restrict or eliminate the right to sue the other party in an accident, except in the more serious cases defined by that state's law. Victims with less serious injuries collect their out-of-pocket expenses from their own insurers without the need for expensive legal proceedings.

A similar concept of liability without regard to fault applies to workplace injuries. Each of the fifty states has a workers compensation statute. Such a statute eliminates an employee's right to sue the employer for most work-related injuries and also imposes on the employer automatic (strict) liability to pay specified benefits. In place of the right to sue for negligence, workers compensation laws create a system in which injured employees receive benefits specified in these laws. As long as the injury is work-related, the employer pays the specified benefits (such as medical, disability, and rehabilitation benefits) regardless of who is at fault.

Apply Your Knowledge

The Smiths were having an anniversary party at their home. They served beer and wine to their guests, including Barry, who drank too much wine. He missed a patio chair he was trying to sit in. He broke his wrist in his fall. He incurred thousands of dollars in medical bills and lost wages because of his injury. When he discovered the chair in question was rotten and would have fallen apart had he sat in it, he sued the Smiths, alleging negligence. Applying the four elements of negligence, are the Smiths likely to be found legally liable for Barry's injuries?

Feedback: The Smiths did owe a legal duty of care to Barry because he was their guest at their party and on their premises. So Barry would likely be able to satisfy the requirements of the first element.

The second element requires the Smiths to have breached a duty of care to Barry. This may have occurred in two ways. First, the Smiths provided the wine Barry became intoxicated with. As the hosts for the party, the Smiths may be found to have failed to accurately monitor Barry's drinking and allowed him to become a danger to himself. Second, the chair was rotten because of poor maintenance and presented a dangerous condition. Both of these breached duties could be found to be failures to exercise the reasonable degree of care expected in this situation. So Barry would likely be able to satisfy the second element.

However, the third element requires that the breach of duty initiate an unbroken chain of events leading to the injury. That is, the breach of either duty owed must be the proximate cause of Barry's injury. Regarding the first duty, Barry is an adult and presumably capable of acting responsibly enough to avoid getting so intoxicated he is unable to perform the simple act of safely sitting down. Further, Barry drank the wine voluntarily and therefore his own negligence may break the chain of events of the first duty. Regarding the second duty, the chair may have been rotten and unable to support Barry's weight, but that is not what caused his injuries as he missed the chair in his fall. Barry may have difficulty proving the requirements of the third element have been met.

The fourth element requires Barry to have actually suffered damages. He has incurred thousands of dollars in medical expenses and lost wages because of his fall. Barry will likely be able to prove the fourth element is satisfied. Because Barry has to prevail on all four elements and the third element will likely not be found in his favor, he will probably not be able to prove that the Smiths were negligent.

LIABILITY LOSS EXPOSURES

Understanding the elements of liability loss exposures provides an essential foundation for managing them.

These are the three elements of liability loss exposures:

- Assets exposed to liability loss
- Causes of liability loss
- Financial consequences of liability loss

Assets Exposed to Liability Loss

The first element of liability loss exposures consists of assets exposed to liability losses. The asset can be anything of value an individual or organization owns. However, the asset that plaintiffs claim most frequently is money. Money can be used, for example, to make a payment of damages to a plaintiff or to pay attorneys' fees and other costs of defending against claims. Assets owned by an individual or organization, such as property (including buildings, automobiles, and furniture) and investments, can be sold and converted to money that can be used to make a payment to a plaintiff. Furthermore, a plaintiff can claim income that a defendant will receive in the future.

Causes of Liability Loss

The second element of liability loss exposures consists of the causes of liability losses. The cause of a liability loss is the initiation of a claim or lawsuit against an individual or organization by another party seeking damages or some other legal remedy. Even the threat of another party's initiating such a claim or suit can cause a liability loss in the form of costs an individual or organization incurs to investigate and, if necessary, settle the threatened liability claim or suit. Liability claims can arise from various activities. Such activities include these:

- Autos, watercraft, and other vehicles
- Premises
- Personal activities
- Business operations
- Completed operations
- Products
- Advertising
- Pollution
- Liquor
- Professional activities

Autos, Watercraft, and Other Vehicles

A significant liability loss exposure for almost all persons and businesses comes from the ownership, maintenance, and use of automobiles. In the United States, auto accidents produce the greatest number of liability claims. Even people or businesses that do not own an auto can be held vicariously liable for the operation of an auto by others. For example, an employer could be held liable for an auto accident caused by its employee making a sales call on a customer, whether the employee was driving his own vehicle or one owned by the employer.

Liability loss exposures are also created by owning and operating other conveyances, such as watercraft, aircraft, and recreational vehicles.

Premises

Anyone who owns or occupies real property has a premises liability loss exposure. If a visitor slips on an icy front porch and is injured, the homeowner may be held liable for the injury. A business has a similar loss exposure arising from its premises. For example, a grocery store will probably be held liable if a customer is injured after slipping and falling on a wet floor in the store.

Personal Activities

Individuals can become liable to others when engaged in a personal activity not business related and away from the defendant's premises. For example, a person could hit a golf ball off a tee at a golf course and strike and injure another golfer with the ball. The activity need not be recreational; it could involve, for instance, owning a dog that escapes from the owner's premises and bites a neighbor.

Business Operations

In terms of liability loss exposures, businesses must be concerned not only about the condition of their premises but also about their business operations. Whatever activity the business performs has the potential to cause harm to someone else. Many business operations occur away from the organization's premises. A plumbing contractor, for example, may start a fire in a customer's house while soldering a copper pipe. Similarly, a roofing contractor may drop debris from a ladder and injure a member of the customer's family. In both cases, the customer could make a liability claim against the contractor.

Completed Operations

Even after a plumber, an electrician, a painter, or another contractor completes a job and leaves the work site, a liability loss exposure remains. If faulty wiring or toxic paint leads to an injury, the person or business that performed the work may be liable. Considerable time could pass in the interim, but the person or business may still be held liable if faulty work created the condition that eventually caused the injury. If, for example, a homeowner could prove that a natural-gas explosion in her house was caused by the negligence of the contractor who installed her new furnace, the contractor may be liable for the resulting damage to the house.

Products

Liability resulting from products that cause bodily injury or property damage is a significant exposure for manufacturers. This exposure begins with the design of the product and might not end until the consumer properly disposes of the product. Millions of customers use or consume mass-produced products, foods, and pharmaceuticals. A prescription drug may be dangerous, but the danger might not be known for several years, after which it is too late to help those who have taken the drug.

Advertising

Businesses often include photographs of people using their products in their advertisements. If a local retailer cannot afford professional models, it might use pictures of people using its products or shopping in its store. Unless the retailer obtains proper permission, publishing the pictures could lead to a lawsuit alleging invasion of privacy. Using another company's trademarked slogan or advertisement can also generate a liability claim.

Pollution

Many types of products pollute the environment when they are discarded. In addition, the manufacture of some products creates contaminants that, if not disposed of properly, can cause environmental impairment, or pollution. If an explosion at an oil refinery polluted a nearby body of water, the refinery owner might have a liability loss. The Love Canal case in New York State remains a good example of how industrial products or wastes can have serious detrimental effects on the environment. Toxic wastes in the Love Canal area polluted the ground water and made the surrounding community a dangerous place to live. Cleanup costs and expenses to relocate persons living in the contaminated area can be enormous in such cases.

Liquor

The consumption, serving, and sale of alcohol can present liability loss exposures. Intoxicated persons can pose a threat to themselves as well as to others. Providers of alcohol can be held responsible for customers or guests who become intoxicated and injure someone while driving drunk. Both the drunk driver and the person who served the alcohol can be held legally liable. A business that sells or serves alcoholic beverages, therefore, has a significant liability loss exposure.

Professional Activities

Negligence involves a failure to exercise the degree of care that is reasonable under given circumstances. It is reasonable to expect that professionals with special competence in a particular field or occupation will exercise a higher standard of care in performing their duties than someone without special competence. Attorneys, physicians, architects, engineers, and other professionals are considered experts in their field and are expected to perform accordingly. Professional liability arises if injury or damage can be attributed to a professional's failure to exercise the appropriate standard of care. For insurance professionals and others, this failure is sometimes called errors and omissions (E&O). For medical professionals, it is often called malpractice. For example, a physician who prescribes a drug but ignores the possible side effects may be held liable for any resulting harm to the patient, because accepted medical practice requires the doctor to consider possible side effects. When professionals make errors, the injured party usually expects to be compensated.

Financial Consequences of Liability Loss

The third element of liability loss exposures consists of the financial consequences of such losses. In theory, the financial consequences of a liability loss exposure are limitless. In practice, financial consequences are limited to the total wealth of the person or organization. Although some jurisdictions limit the amounts that can be taken in a claim, liability claims can result in the loss of most or all of a person's or organization's assets. For a person or an organization that has been held legally liable for injury or damage, the financial consequences can be the payment of damages, the payment of defense costs, and damage to the person's or organization's reputation.

Damages

The damages of a liability loss can be more difficult to determine than those involved with other types of losses. For example, the ultimate value of liability claims resulting from a hotel fire injuring hundreds of guests may be hard to predict because each claim is different and it may take years for all of them to reach settlement or be tried in court to a final judgment.

Defense Costs

In addition to damages, the financial consequences of a liability loss may include costs to defend the alleged wrongdoer in court. These defense costs include not only the fees paid to lawyers but also all the other expenses associated with defending a liability claim. Such expenses can include investigation expenses, expert witness fees, premiums for necessary bonds, and other expenses incurred to prepare for and conduct a trial. Even in the unlikely event that all the possible lawsuits against a defendant are ultimately found groundless, defendants and their liability insurers will probably incur substantial defense costs.

Damage to Reputation

A third financial consequence of liability loss may be the defendant's loss of reputation. Such consequences are often difficult to quantify, but they do exist. For example, in 2000, a tire manufacturer recalled more than six million tires after they were alleged to be a factor in rollover crashes. In addition to damages paid and defense costs for the lawsuits that followed, the manufacturer suffered a damaged reputation and resultant loss of sales.

Apply Your Knowledge

Robert and Lillian are married and own a home with a pool in the backyard. Robert frequently goes hunting for sport. Joey, their son, plays Little League baseball. Their daughter, Sally, plays soccer on a team in an organized league. Lillian frequently drives Sally and several of her teammates to and from games. Lillian also serves on the local YMCA board. Describe the family's liability loss exposures in terms of these three elements:

- Assets exposed to a liability loss
- Causes of liability loss
- Financial consequences of liability loss

Feedback:

- Assets exposed to liability loss—Robert and Lillian's cash accounts, home, furniture, autos, future income, and other personal property are exposed to the risk of being liquidated to pay damages to a plaintiff.
- Causes of liability loss—Claims and suits by plaintiffs could result from any of the activities described. The swimming pool in the backyard is a premises loss exposure that could attract neighborhood children. If a child were to drown while swimming in the pool, his or her parents could accuse Robert and Lillian of negligence. Robert's hunting is a personal activity that could result in a claim for accidently shooting a person. Joey's playing baseball is a personal activity that could result in a claim that Joey hit someone with a ball or bat. Sally's playing soccer is a personal activity that probably has the least significant liability exposure, but other players could claim she injured them by running into or tripping them. Lillian's driving Sally and her teammates to and from games is an auto-related activity that could result in an auto accident and claims that she negligently injured the teammates. Lillian's board service could be considered a professional activity, which could in turn result in a claim alleging that she failed to exercise the standard of care expected of a board member.
- Financial consequences of liability loss—Each of these activities could result in a claim or suit whose value is limited only by the wealth of the family. Even if the claim or suit is without merit, the defense costs and damage to the family members' reputation may be substantial.

PERSONNEL LOSS EXPOSURES

For many organizations, their most valuable assets are their employees because they add to the value of the organization through their physical and mental labor. Understanding the elements of personnel loss exposures provides an essential foundation for managing these exposures and protecting these assets.

Personnel loss exposure

A condition that presents the possibility of loss caused by a person's death, disability, retirement, or resignation that deprives an organization of the person's special skill or knowledge that the organization cannot readily replace.

Key employee

An employee whose loss to a firm through death or disability before retirement would have economic effects on the company.

A **personnel loss exposure** is composed of these elements:

- Assets exposed to a personnel loss
- Causes of a personnel loss
- Financial consequences of a personnel loss

Assets Exposed to Personnel Loss

While everyone in an organization has value, some people are more easily replaced than others. Valuable employees (**key employees**) present a critical loss exposure to an organization. Similarly, groups of employees who perform crucial functions, if they are all lost simultaneously, can cause a crisis for an organization.

Personnel loss exposures can include several categories of key personnel:

- Individual employees
- Owners, officers, and managers
- Groups of employees

Individual Employees

The category of individual employees includes employees with unique talents, creativity, or special skills vital to the organization's ability to meet its goals. These employees do not own, manage, or oversee the organization, but they add value to it. They could be high-performing sales representatives or systems engineers who help focus a firm's efforts on customer needs during a complex engineering project.

Owners, Officers, and Managers

Owners, officers, and managers are responsible for making decisions essential to the organization, as well as managing and motivating others. In organizations in which the owner is a key person, that person's activities, health, and managerial competence all influence the organization's value. A sole proprietorship literally ceases to exist as a legal entity when its owner dies or retires. Similarly, partnerships may legally terminate when a partner dies or retires. The same is true in close corporations, in which ownership is typically concentrated in just a few major shareholders, most of whom are also managers.

Reality Check

Example of Losing a Key Person

Steve Jobs of Apple, Inc., is an example of how one visionary key person can have a major influence on the success of even a large corporation. The company, which relied on Jobs for its run of successes, was shaken by his health concerns that started when he was diagnosed with pancreatic cancer in 2003. As part of Apple's succession plan to replace Jobs' contributions, the company has hired high-profile academics to provide training for its executives.

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Groups of Employees

Sometimes a group of employees is critically important to an organization, even if an individual employee in that group is not. An organization may be unable to function without the contributions of an important group. With the exception of layoffs, group departure is rare, and when an entire group is laid off, it is usually because it is considered expendable. However, over a short time period, an entire group may leave because of common dissatisfaction (such as poor management), may follow a manager to a new organization, or may be lost because of a catastrophic event.

Causes of Personnel Loss

The causes of personnel losses are the actual means by which an employee is removed from the service of an employer. Each cause of loss varies considerably in frequency and severity. These are some of the major causes of loss:

- Death
- Disability
- Resignation, layoffs, and firing
- Retirement
- Kidnapping

Causes of loss could occur inside or outside the workplace; however, the personnel loss remains the same in both instances.

Death

The death of an employee results in the complete, permanent loss of the employee's services. Unless a disaster occurs, most losses from death are low frequency, and the severity of impact on the employer depends on the employee's value to the organization. The risk of death varies widely according to the nature of the organization's business (for example, financial services versus oil exploration and extraction). Numerous events, accidental or natural, can cause death of key employees. Risk control efforts can focus on events that can result in the death of large numbers of employees at once, such as fire, explosion, severe windstorm, and terrorist attacks.

Disability

Although death as a cause of loss often attracts more media attention than disability, overall disability occurs far more frequently than death. The severity of personnel losses resulting from **disability** can be equal to those resulting from death if the disability is permanent and total. However, temporary disability is more common than permanent disability, and partial disability is more common than total disability.

Disability

The inability (because of impairment) of a person to meet his or her personal, social, or occupational demands; other activities of daily living; or statutory or other legal requirements.

As with death, numerous accidental or natural events can cause disability of key employees. Risk control efforts can focus on events that can disable large numbers of employees at once and on events that disable many employees over time, such as workplace injuries.

Workplace injuries are often related to companies' failing to take adequate safety measures. Examples include these:

- Failing to apply ergonomics to prevent injuries, such as carpal tunnel syndrome, from repetitive motions
- Not allowing workers performing physical labor to take periodic breaks
- Operating an assembly process too quickly, thereby encouraging workers to take chances assembling products and increasing their exposure to potential injury

Resignation, Layoffs, and Firing

Employees may leave an employer voluntarily (for example, by resignation) or involuntarily (for example, by a layoff or firing). Resignation (voluntary separation) is an expected part of doing business. The frequency of resignations depends, in part, on the type of industry. Some organizations, such as fast-food restaurants or construction companies, could expect very high turnover rates, while others, such as accounting firms or governments, could expect a low turnover rate. The severity of a resignation depends on who is resigning. If a key person leaves or if a group of employees sharing a similar function departs simultaneously, the severity of the personnel losses may be high.

Involuntary employee separations generally are not considered a personnel loss because the organization has determined that it is better off without the employees. If, for example, a layoff is the result of a change in the organization's goals—meaning that the laid-off employees are no longer needed for the organization to operate efficiently—their departure will have a minimal effect on the organization's success. Employees are typically fired for cause—that is, for not performing their jobs effectively or behaving in an unacceptable manner. Usually, organizations rationally consider all the costs and benefits of retaining an employee before firing him or her.

Retirement

While death and voluntary resignation often occur suddenly, retirement is usually planned. With plenty of notice, an organization can usually prepare for the retirement of even key personnel by locating and training replacements. However, as with resignation or death, when a key person decides to retire suddenly, the losses can be severe.

Kidnapping

Kidnapping of a key employee can be a significant cause of loss for employers, especially for those with operations outside the United States. Some kidnappings result from political unrest, but employers are more likely to face financially motivated kidnappings, such as kidnapping for ransom.

Kidnapping is a fairly low-frequency event that tends to occur mostly in high-risk locations. The most obvious loss to an employer is the absence of a key employee. In this sense, kidnapping losses are similar to death and disability losses; the severity depends on the importance of the employee and the cost of temporarily or permanently replacing him or her.

Financial Consequences of Personnel Losses

Because employees are assets of an organization, the financial effect of the loss of these assets (personnel losses) on an organization is similar to the effect of property and liability losses in that they reduce the value of the organization. The major difference is that personnel losses typically manifest themselves as net income losses. These are some of the financial consequences of personnel losses:

- Loss of the value the employee contributed to the organization. (In cases in which a key person is lost, this may be severe, with the organization's value lowered at least for the short term.)
- Replacement costs (recruitment, interviewing, and training of replacement personnel).
- Losses to the organization's value caused by negative publicity.
- Losses caused by low morale, such as reduced productivity and increased illness.

Apply Your Knowledge

Roger and Susan are realtors and employees of the same real estate agency. Roger has been with the agency for thirty years and plans to retire next month. He has an excellent reputation and almost more referral business than he can service. Susan has been with the agency for a year and is considering a job offer from another agency. She is a hard worker but is still learning how to best serve her clients and has few referrals. Roger and Susan were traveling to a sales convention in Susan's car when they were broadsided by a driver who failed to stop at a red light. Both Roger and Susan were injured and taken to a hospital. The doctors estimate both Roger and Susan will be totally disabled for four months. Describe the real estate agency's personnel loss exposures in terms of the three elements of personnel loss exposures:

Feedback:

- Assets exposed to personnel loss—Roger and Susan are valuable assets of the agency because they add to the value of the organization through their physical and mental labor. While both Roger and Susan have value, Susan can be replaced more easily than Roger. Roger is a key employee of the agency because of his referral business, which provides substantial income to the agency.
- Causes of personnel loss—The four-month disability resulting from the auto accident is an immediate cause of loss for the agency. Roger's planned retirement is another cause of loss. By the time Roger recovers from the accident, it will be past his retirement date. So, in effect, the

agency might as well consider Roger's disability to be permanent. Susan's potential resignation to go work for another agency once she recovers from her disability is another possible cause of loss.

- Financial consequences of personnel loss—The referral business may not continue if Roger is not working at the agency. However, Roger's employer probably knows about his planned retirement date. Therefore, his replacement has likely been hired and trained and may have met with Roger's clients to assure them that the same excellent level of service will continue after Roger's departure. The costs to replace Roger were probably incurred before the auto accident, and Roger's loss of value to the agency minimized. Furthermore, the accident may generate sympathy in the market that may result in more business for the agency. Susan has few referrals, and her absence will not be as much of a loss to the agency economically whether she comes back in four months or decides to work for another agency.

NET INCOME LOSS EXPOSURES

Understanding the elements of net income loss exposures and how they result from other causes of loss provides an essential foundation for managing such exposures.

A net income loss exposure is a condition that presents the possibility of loss caused by a reduction in net income. These are the three elements of net income loss exposures:

- Assets exposed to net income loss
- Causes of net income loss
- Financial consequences of net income loss

Assets Exposed to Net Income Loss

The asset exposed to loss in a net income loss exposure is the future stream of net income of the individual or organization. The future stream of net income includes revenues minus expenses and income taxes in a given time period. If income taxes are considered to be part of an organization's expenses, a net income loss is a reduction in revenue, an increase in expenses, or a combination of the two.

For example, a fire at an organization's production facilities could not only destroy the facilities (a property loss exposure), but also force the organization to stop operations for a few weeks, resulting in a loss of sales revenue (a net income loss exposure). Similarly, if a tornado damaged the retail store of a self-employed business owner, the inability to earn income while the store is being repaired represents a net income loss exposure.

Net income losses are often the result of a property, liability, or personnel loss (all of which are direct losses). Therefore, net income losses are considered to be indirect losses. A direct loss is a loss that occurs immediately as the result of a particular cause of loss, such as the reduction in the value of a building that has been damaged by fire.

An indirect loss is a loss that results from, but is not directly caused by, a particular cause of loss. For example, the reduction in revenue that an organization suffers as a result of fire damage to one of its buildings is an indirect loss. Estimating indirect losses is often challenging because of the difficulty in projecting the effects that a direct loss will have on revenues and expenses. For instance, a litigation manager working for a restaurant chain may be able to project with some certainty the amount needed to settle a lawsuit brought by a customer accusing the restaurant of food poisoning (a direct liability loss). However, projecting the effect on future restaurant sales (an indirect loss) of any negative publicity relating to the lawsuit would be more difficult.

In the insurance industry, the term "net income losses" is usually associated with property losses, and some insurance policies provide coverage for net income losses related to property losses. However, there are many other causes of net income losses.

Causes of Net Income Loss

Various circumstances can lead to a net income loss. For many of these causes of loss, it can often be difficult to discern when the direct property loss, liability loss, personnel loss, or business risk loss ends and when the indirect net income loss begins.

Property Loss

A property loss is a loss sustained by a person or an organization resulting from damage to property in which that person or organization has a financial interest. Damage to property can cause a reduction in that property's value, sometimes to zero. For example, when a car is stolen, the owner suffers a total loss of that property because the owner no longer has use of it. As a result of the theft, the owner could incur a net income loss by renting a replacement vehicle. The owner's expenses will increase, but the added expense may be necessary in order to allow the owner to continue commuting to and from work.

Similarly, a nuclear power plant that just endured an earthquake may incur a net income loss when it pays the extra expense of immediately shipping in a replacement water pump. By incurring the additional shipping costs to receive the pump more quickly, the plant may be able to prevent a larger direct loss of radiation contamination and resume operations sooner. This action would also avoid a larger loss of income and, consequently, a larger net income loss.

months.If the apartment over the garage also became uninhabitable, the young couple would move out, and the monthly rent they paid would stop. Without the rental income, Sally may not be able to pay the full amount of the mortgage herself, which could result in the bank declaring her mortgage in default and foreclosing on the property. Sally and her boys would then lose their home.

- Liability loss—If the husband of the young couple slipped on the outdoor stairs going down to his car and injured his knee, he may decide to sue Sally. He could claim the stairs were not properly maintained and presented a hazardous condition that she should have prevented. Sally would incur the direct costs of her defense but may also incur the indirect costs of repairing the steps and losing income for being off work on the days she must attend trial of the lawsuit. The indirect costs would increase Sally's expenses and thereby lower her net income.
- Personnel loss—The newspaper for which Sally works has been losing advertising income for years. If its management decides it must cut expenses, it may decide to do so by laying off workers, including Sally. She will probably be able to find other employment eventually, but until she does, her family will lose the income she would have earned.

SUMMARY

Property loss exposures are analyzed in these terms:

- Assets exposed to property loss
- Causes of loss to property
- Financial consequences of property losses
- Parties affected by property losses

Legal liability can arise based on torts, contracts, and statutes. Types of torts include negligence, intentional torts, and strict liability. Examples of liability based on contracts include hold-harmless agreements and warranties in contracts for sale of goods. Examples of liability based on statutes involve no-fault auto laws and workers compensation laws.

These are the three elements of liability loss exposures:

- Assets exposed to a liability loss, which include a defendant's property and future income
- Causes of liability loss, which could arise from various activities
- Financial consequences of liability loss, which include damages, defense costs, and damage to reputation

These are the three elements of personnel loss exposures:

- Assets exposed to a personnel loss, which include individual employees; owners, officers, and managers; and groups of employees
- Causes of a personnel loss, which include death, disability, resignation, layoffs, firing, retirement, and kidnapping
- Financial consequences of a personnel loss, which include loss of the value of an employee's contribution, replacement costs, loss due to negative publicity, and reduced productivity and increased illness caused by low morale

Net income loss exposures are characterized by these three elements:

- Assets exposed to a net income loss exposure—The future stream of net income of the individual or organization.
- Causes of net income loss—Direct property, liability, and personnel losses or business risks.
- Financial consequences of net income loss—These include a reduction in revenues, an increase in expenses, or a combination of the two.