INSURANCE EXAM · IC-74

IC-74 Liability Insurance

Revision book

13	2	133
chapters	master tables	numbered sections

FREE SAMPLE: Chapter 1 of 13

CHAPTER 1

Introduction To Liability Insurance

1.1 Legal liability
1.2 Sources of civil liability
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MUST KNOW

1. Legal liability = legal duty to pay compensation; criminal (State, fine/jail) or civil (party sues party).
2. Only civil liability is insurable; a criminal act cannot be covered.
3. Civil liability arises from common law, statute and contract.
4. **Liability insurance types:** statutory and tort. Also: property and casualty, and financial liability.
5. Claims are paid to the third party (or employee) on behalf of the insured.
6. **Limits:** AOA and AOP/AOY, ratio 1:1 to 1:4 in amounts; employers' liability policies state no limit.
7. Subrogation = corollary of indemnity; contribution replaced by Other Insurance clause.
8. **Proposal declaration:** any wrong answer makes the contract voidable, material or not.
9. **History:** UK **1875** first public liability policy; **1880** first employers' liability company; UK compulsory EL Act from **1 Jan 1972**.

1.1 Legal liability

- Liability = responsibility; legal liability = responsibility the law can enforce.
- Courts decide it, even if parties settle outside court.

Class	Who acts	Result
Criminal	State	Fine, jail or both
Civil	One party sues another	Damages or compensation

TRAP

Criminal liability cannot be insured.

1.2 Sources of civil liability

- **Common law:** past court decisions, customs and usages; e.g. negligently causing injury or damage.
- **Statute:** Act of Parliament; e.g. employee compensation law (**1923** Act, repealed **21 Nov 2025**; now Code on Social Security **2020**) (liable even without negligence); PLI Act **1991** (no-fault, hazardous substances).
- **Contract:** Indian Contract Act 1872, in force **1 Sep 1872**; e.g. builder late in finishing.

TODAY'S RULE

Workmen's Compensation Act **1923** (renamed Employees' Compensation Act) and ESI Act **1948** were repealed on **21 Nov 2025**; the Code on Social Security **2020** now carries both.

Motor Vehicles Act: **1988** Act as amended **2019** (**1939** Act is history).

1.3 Types of liability insurance

- **Statutory:** liability set by a specific law (compensation, motor, PLI Act, an old Steamships Act).
- **Tort:** from common law judgments (public, professional, product liability).
- **Property and casualty:** damage to third-party property, injury or death.
- **Financial:** money loss to third parties (professional, D&O).
- **Purpose:** indemnify defence costs, damages and compensation.
- **Road accident:** first under Motor Vehicles Act (motor TP); if short, common law court.

1.4 History

Year	Event
1875	UK: first public liability policy (horse-driven vehicles)
1876	Boiler policies add cover for surrounding property
1880	Employers' Liability Act; first EL company (Employers' Liability Assurance Corporation)
1888	Third party (lift) policies
1897	Workmen's Compensation Act
1906	WC Act; fire insurers enter EL
1942	Beveridge report
1946	National Insurance (Industrial Injuries) Act: repealed **1880** and **1906** Acts; commercial WC ended
1 Jan 1972	EL (Compulsory Insurance) Act **1969** in force, Great Britain

- **Accident Offices Association:** rating.
- **1880** Act created demand for public liability; then property owners', school authorities', sportsmen's indemnities.
- **Professional indemnity:** early 20th century. Products liability: food and drink (hotels), dermatitis from furs and woollens.
- **EL after 1946:** common law cover continued under EL policies.
- **Compulsory EL:** authorised insurer; fixed cover per occurrence.

1.5 India

- WC Act **1923** -> employers' liability; MV Act **1939** -> compulsory motor TP.
- Bhopal **1984**; public interest litigation; judicial activism.
- Environment Protection Act **1986**; PLI Act **1991**.
- Medical services under consumer law -> doctors' professional indemnity.

TODAY'S RULE

Consumer Protection Act **2019** (in force **20 Jul 2020**) replaces the **1986** Act.

- ESI Act **1948** (ESIC; repealed **21 Nov 2025**, scheme now under the Code on Social Security **2020**); compensation law not applicable where ESI applies; EL policy still needed for common law liability.

1.6 Insurable interest

- Legal right to insure.
- **3 essentials:** (1) potential legal liability that can be insured; (2) it is the subject matter; (3) legal link: gains if no liability, loses if liability arises.
- Must be measurable in money (damages, defence costs).
- **Others may have interest:** collaborator (technical collaboration), vendors (products liability for exports).

1.7 Indemnity

- Recovery only up to insurable interest; no profit.
- Legal costs (awarded and own) covered with insurer's written consent.
- Payment on behalf of and through the insured; no direct interest in settlement.

FORMULA AND WORKED SUM

- Limit Rs 10,00,000; claims + costs Rs 12,10,000 -> insurer 10,00,000, insured 2,10,000.
- Claims + costs Rs 8,50,000 -> insurer pays 8,50,000 only.

Limit	Meaning
AOA	Any One Accident: all claims from one accident
AOP / AOY	Any One Period / Year: all claims in the policy period
Aggregate	Any one loss and in aggregate in schedule

- **AOA :** AOY = 1:1, 1:2, 1:3, 1:4 (amounts, not number of claims).
- Insured chooses the limit.
- **Factors:** business; exposure, asset size, shareholding; public perception; income of area; customers; ability to pay premium; defence cost inside or outside; persons/locations; territory and jurisdiction.
- **EL policy:** no limit; no PML in liability underwriting; compensation-law damages by scale in that law.
- Legal costs inside the limit today; in WC insurance, in addition.

1.8 Subrogation, contribution

- **Subrogation:** transfer of insured's rights and remedies to the insurer who indemnified; corollary of indemnity; implied in all indemnity contracts.

FORMULA AND WORKED SUM

- **Retailer's product liability:** insurer pays customer, then recovers from wholesaler or maker.

- **Contribution:** insurer who paid recovers proportionate share from other insurers.
- **Replaced by Other Insurance clause:** after first policy limit is exhausted, claim the balance from the other insurer.

1.9 Utmost good faith

- Fiduciary contract (not "let the buyer beware"); disclose all material information.

- **Proposal declaration:** answers warranted true, basis of contract.
- Wrong answer -> voidable at insurer's option, material or not; common law duty becomes contractual.
- Survey for large or hazardous risks; insurer deemed to know what the insured let it see.
- Disclosure continues during the policy; insured acts as if uninsured.
- **WC policy Condition 3:** reasonable precautions, statutory compliance.

> **TRAP**
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> **Example:** denied "no welding or hot work" in form, visitor died by gas cutting -> claim rejected.

1.10 Scope

- Act policy (PLI Act); public liability; products; combined/commercial general; professional indemnity (E&O); WC/employees' compensation; D&O; others.
- Also in motor, marine hull, aviation; package policies with public liability section.
- **Extensions in material damage:** Contractors' Risks, Erection Risks, Boiler explosion.

> **TRAP**
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> Contractual liability is not in the scope list as a policy.

1.11 Special features

- Claims paid to third party/employee on behalf of the insured (third party often unknown at inception).
- Indemnity for potential legal liability (common or statute law).
- Insured settles claims with insurer's consent and must co-operate.
- Legal costs with insurer's written consent reimbursed.
- Limit of indemnity, not sum insured; EL no limit.
- **Jurisdiction clause:** courts restricted to named territories.