

When Is an Insured Not an Insured?

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The first step in accurate coverage interpretation of the commercial general liability (CGL) insurance policy is identifying who is an insured and when protection applies. There is an important distinction between a named insured specifically listed on the policy Declarations and a person or organization that is granted insured status based upon their relationship to the listed named insured. The named insured has broad rights and coverage under the CGL policy, the additional insured has qualified or limited coverage as an insured. It is crucial to recognize the difference.

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To properly comprehend the workings of any liability policy, it is critical to understand not only what events or activities are covered but also who is insured by the policy. Whether the liability coverage is an auto, umbrella, CGL, or even a homeowner's policy, a firm grasp of exactly who is receiving protection is essential to accurate coverage interpretation. But identifying *who* is an insured is only the first step—knowing the *activities* or *events* for which a person is protected and when that protection applies is just as vital.

Who Is an Insured—Section II

Identifying those receiving protection as an insured person or organization under the 2001 Insurance Services Office, Inc. (ISO), commercial general liability policy is relatively straightforward. Section II of the CGL policy, entitled "Who Is an Insured," is divided into four sections and lists each person or organization that receives insured status and the activities for which each is insured.

At the outset, it is crucial to recognize a distinction between a named insured specifically listed on the Declarations (referred to in the policy is "you" or "your") and a person or organization that is granted insured status based upon their *relationship* to the listed named insured. The former has broad rights and coverage under the CGL policy, the latter has qualified or limited coverage as an insured.

Category One—Type of Organization

The first category of an insured is determined by the form of business or organization of the named insured designated on the policy Declarations page.

Sole Proprietors and Spouses. If a named insured is designated on the Declarations as an individual (sole proprietor), he or she is *personally* protected as an insured, as is their spouse, but *only* for activities on behalf of the business of which the named insured is the sole owner. Coverage does not extend to any personal activities of either the named insured or spouse not related to that business. Any non-business personal risk is more appropriately covered by *personal* liability insurance, usually by a homeowner's liability and/or personal umbrella policy. If the spouse owns a separate business, that spouse needs to be listed as a named insured on another CGL policy to obtain liability protection.

Partnerships and Joint Ventures. A partnership or joint venture designated as a named insured receives protection as an insured organization. In addition, the partners of the named insured partnership (and their spouses) or members of a named insured joint venture (and their spouses as well) are also personally insured, but only with respect to the conduct of the business of the named insured partnership or joint venture.

Any other activities, either business or personal, that are not conducted on behalf of the named insured partnership or joint venture leave the partners or members without the protection of the CGL.

Limited Liability Companies. Limited liability companies, a form of organization that is a hybrid between a partnership and corporation, are protected if the limited liability company is designated as a named insured on the Declarations page. Members (owners) of a named insured limited liability company are granted personal protection but only for conduct of business on behalf of the named insured limited liability company.

Managers (executives) are also personally insured, but only for their duties as managers of the named insured limited liability company. No automatic coverage is granted for spouses of members or managers of a limited liability company (unless the spouse is found to have acted as either an employee or volunteer worker of the named insured).

The importance of correct, complete, and timely listing of a partnership, joint venture, and limited liability company as a named insured cannot be overemphasized. The last paragraph of Section II, Who is an Insured, spells out why:

No person or organization is an insured with respect to the conduct of any current or past partnership, joint venture or limited liability company that is *not shown as a Named Insured on the Declarations*. [Emphasis added.]

Other Organizations. For other organizations designated as a named insured (often corporations), insured status applies to the organization itself. A named insured corporation's executive officers (defined as a person holding any officer positions created by the named insured's charter, constitution, by-laws, or any other similar governing document) and directors are also personally insured by the CGL, but that protection is restricted to their duties as officers and directors of the named insured.

Stockholders are personally protected for their liability as stockholders of the named insured.

As every person is *personally* liable for their own torts, even if the torts are business torts committed while acting solely on behalf of a corporation, this protection is extraordinarily important to owners of small corporations. An all too common misunderstanding of business owners is that the "corporate veil" shields the owner from *all* tort liability.

For all of the above, any liability that may arise out of nonbusiness personal activities must be covered by personal liability insurance.

Trusts. If a trust is designated on the Declarations, the trust is granted insured status. Any trustee is also an insured, but only with respect to their duty as a trustee for the named insured trust.

Category Two—Insured in Any Organization

For *any* form of organization, volunteer workers, employees, real estate managers (who are not employees), a person with temporary custody of the named insured's property if a named insured dies as well as their legal representative all have limited insured status under this category.

Volunteer Workers and Employees. Volunteer workers are personally protected while performing duties related to the conduct of the named insured's business; employees are also personally protected, but only for acts within the scope of their employment for the named insured or while performing duties related to the conduct of the named insured's business.

Protection is further restricted in that insured status *does not apply* to either a volunteer worker or an employee because of bodily injury or personal and advertising injury:

- To the named insured, partners, members, co-employees (while the other co-employee is in the course of the named insured's employment or while performing duties related to the conduct of the named insured's business) or other volunteer workers (while the other volunteer worker is performing duties related to the conduct of the named insured's business);
- To the spouse, child, parent or brother of the co-employee or volunteer worker that is a consequence of the injury to the co-employee or volunteer worker;
- To the obligation to share or repay damages someone else must pay because of the injury to the co-employee or volunteer worker;
- Arising out of or failing to provide professional health care services;

Similarly, volunteer workers and employees are not granted protection as an insured for property damage to property:

- Owned by, occupied by, used by;
- Rented to, in the care, custody or control of, or over which physical control is being exercised for any purposes by the named insured or any of the named insured's employees, volunteer workers, partners or members.

Real Estate Managers. Non-employee (independent contractors) who are real estate managers of the named insured are automatically protected with insured status, but only while acting as the named insured's real estate manager. Protection does not extend to the real estate manager's own activities if unrelated to the named insured.

Persons with Temporary Custody. If the named insured dies, anyone with proper temporary custody of the named insured's property, such as a relative maintaining a rental property while affairs of that business are being wound up, is an insured. Coverage is limited to liability arising out of the maintenance or use of the property and ceases when a legal representative is appointed.

Legal Representative. If the named insured dies, the named insured's legal representative is an insured with respect to his or her duties as legal representative of the deceased named insured. Also, the legal representative does acquire all of the named insured's rights and duties under the policy.

Category Three—Mobile Equipment Registered under MV Laws

Status as an insured extends under this category to any person (non-employee) who the named insured permits to drive mobile equipment on a public highway if that mobile equipment is registered to the named insured under a motor vehicle registration law. Also included as an insured is anyone responsible for the permissive user (such as the employer of the permissive user) *if* the responsible person does not have any other insurance available.

The insured status granted to such a permissive user does not apply to bodily injury to a co-employee of the permissive user or property damage to property owned by, rented to, or in the charge of or occupied by the named insured or the employer of the permissive user.

Category Four—Newly Acquired or Formed Organizations

Finally, limited *named* insured status does extend to organizations a *named* insured acquires or forms as long as those organizations do not have similar insurance available. However, no automatic coverage applies to partnerships, joint ventures, or limited liability companies—these forms of organization must immediately be listed on the policy as a named insured to receive *any* protection.

This named insured status of newly acquired or formed entities is also limited in time—named insured status applies from the date of formation or acquisition and ends in 90 days or the end of the policy period, *whichever occurs first*. Further, no coverage applies to bodily injury or property damage that occurred or to personal or advertising injury offenses committed *before* the named insured formed or acquired the organization.

When Protection Applies

Determining *when* protection applies to an insured can be an infinitely more challenging task. The following are a couple of examples that illustrate some of the issues faced by those who provide advice or interpret coverage.

Retirement—Sole Proprietor. A sole proprietor (individual) carpenter decides to retire and ceases operations after 30 years of business. The carpenter, who has carried continuous liability insurance for the last 10 years, informs his agent of his retirement and requests cancellation of his liability policy and a return of any unearned premium. The agent complies with this request.

A year after the policy is canceled, a wooden deck the carpenter had built 2 years ago collapses, injuring 4 people, one seriously. An investigation reveals the carpenter did not use the right nails to fasten boards on the deck, which was the cause of the collapse. A lawsuit is brought against the carpenter, alleging negligence and demanding damages for the resulting bodily injury. Upon receipt of the lawsuit, the carpenter immediately calls the agent to report the claim and is stunned to learn that no coverage exists for this lawsuit.

An Unwelcome Surprise. The general rule is that the occurrence-based CGL policy in effect *at the time the bodily injury or property damage occurs* is the policy that must respond to the above situation. Although exactly when bodily injury or property damage takes place has often been litigated, particularly when environmental damage or injury is involved, the policy in force when the carpenter negligently built the deck does not generally respond. In other words, despite the fact that the carpenter was a *named insured* and was protected by the CGL *when the deck was built*, the carpenter will receive no protection for future injuries or damages arising out of *past work*.

Discontinued Operations. A solution that could have been offered to the carpenter was for the carpenter to continue to purchase a CGL policy for several years *after* his retirement. Such a policy, usually known as a discontinued operations CGL policy, will protect the carpenter against injury to others or damage to the property of others that may take place *after* retirement arising out of work performed **prior** to retirement. While the last thing the carpenter might have wanted to do was to continue to buy insurance, an explanation as to the risk he was taking by terminating his insurance would have been a prudent action by his insurance agent.

A Lead Parachute. ABC Corporation, Inc. manufactures products (machines) and is managed by their chief executive officer, Jack Doe. ABC's CGL policy, a standard unendorsed ISO CGL occurrence policy (2001 edition), has a calendar year effective date. Jack Doe decides to completely retire from ABC Corporation, Inc., on July 1, 2002. As of his retirement date, Mr. Doe is no longer an employee, director, or officer of ABC Corporation, Inc.

A product made by ABC on February 2, 2002, malfunctions on June 15, 2003, and causes fatal injuries to a consumer. The consumer's estate files a complaint with the trial court alleging liability on the part of ABC Corporation, Inc. under the theory of negligent manufacture of the product. The complaint also names Jack Doe personally for his liability resulting from his alleged breach of duty as chief executive officer to use due care in overseeing the manufacture of the machine that caused the fatality.

The insurer answers the complaint and agrees to defend the named insured, ABC Corporation, Inc., but denies that any coverage could possibly apply to Jack Doe and refuses to defend or consider paying on his behalf. Their reasoning—Jack Doe is not an executive officer *at the time of the bodily injury* and therefore has no insured status under the CGL on June 15, 2003.

When Does an Executive Officer Lose Insured Status? Professional liability policies usually address this issue—insured status is often specifically granted to past, present, or future directors and officers. Some professional liability policies determine the status of an insured (particularly employees) at the time the wrongful act was committed—rather than at the time of the claim or when damages occur, which may be months or years later. The CGL is simply silent on this issue.

An insurer has the option to clearly and unambiguously restrict insured status to apply exclusively to *current* directors or officers. Another approach is for the insurer to clearly grant insured status to *only* to those persons holding officer or director positions *at the time of bodily injury or property damage*. The insurer elected to add neither restriction to the CGL policy. The *only* restriction that applies to insured status of an executive officer is that liability must be with respect to the duties as an officer or director of the named insured.

In the above, the plaintiff is alleging breach of Jack Doe's duty *as an officer of ABC Corporation, Inc.*, the named insured. That the bodily injury took place at a date *later* than Jack Doe's alleged breach of duty as an officer of the named insured does not affect in any way his status as an insured. While the date of the bodily injury is what triggers this CGL policy (and not the alleged breach of duty), a plain reading of the policy *does not* direct or permit the insurer to equate the coverage trigger with insured status. Jack Doe has insured status for the June 15, 2003, injury claim.

A Compelling Interpretation? The determining factor is that Jack Doe was an insured *at the time he was alleged to have breached his duty as an officer of the named insured*. Therefore, Jack Doe is an insured in this situation and is protected by the CGL. The elements of negligence call for the breach of a legal duty owed which causes injury resulting in damages. It is certainly foreseeable that a breach of duty—an act of an insured person—might not result in injury or damage until months or years *after the act*.

Similar Situations—Arising from Acquisitions, Mergers, or Change of Job. For example, suppose Jack Doe's owned 100 percent of the shares of ABC and sold them on July 1, 2002. Would he have insured status for acts as a chief executive of ABC if committed prior to the sale but which result in injury *after the sale*? What if the purchaser agreed to protect Jack Doe in their CGL—would Jack be covered by their policy after the sale?

Suppose a quality control manager (non-executive officer employee) at ABC took a job with another employer on July 1, 2002? Would the quality control manager have insured status under his former employer's policy even though he is not an employee of ABC *at the time of the bodily injury* if personally sued?

Because of the possible time lag between a careless act and the resulting bodily injury or property damage, the insured status of sole proprietors, executive officers or employees is a potential risk issue that is often overlooked. The failure to identify and properly handle such risk is particularly true when operations cease, when people retire, or businesses are sold, acquired, or merged.

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