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THE DANGERS OF ABSOLUTE EXCLUSIONS, AND WHY ARE REGULATORS ALLOWING THEM?

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In 2010, I authored an article on the dangers of absolute exclusions.[1] That article was prompted by an appellate decision in Florida, *James River Ins. Co. v. Ground Down Eng'g,* 540 F.3d 1270 (11th Cir. 2008). In that case, an engineering firm that was providing consulting services on whether land had become polluted found that its errors and omissions (E&O) policy, which covered it as an environmental consultant, didn't cover pollution! Since then, the problem has become even worse, resulting in my four-part series, published by the International Risk Management Institute (IRMI), "Possible Dangers Lurking in Claims-Made Policy Forms." Part 4[2] of said article revisited the problem of absolute exclusions. The *Professional Liability Insurance* section on common features pointed out the following.

There are four general kinds of exclusions contained within professional liability policies.

- Exclusions for uninsurable exposures
- Exclusions removable or modifiable by negotiation, with or without additional premium
- Exclusions for exposures better suited to other types of coverage
- Exclusions for exposures pertaining to a specialized type of work within a given profession

[1]Frederick J. Fisher, "Current Trends: The Unintended Results of the Absolute Exclusion," MyNewMarkets Powered by Insurance Journal (June 2–15, 2010).
[2]IRMI.com, June 2019.

I would like to thank all of the law firms for their appellate summaries over the years, especially those who published "E" version of what would be considered a monthly magazine—thus, a special thank you to the Tressler, LLP, and Wiley, LLP, firms. I also thank all the other authors whose works are cited.

The problem has become epic in that some hazard classes of specialty lines policies today are written with a significant number (if not all) of their exclusions on an absolute basis. Worse still is the fact that the courts are liberally interpreting these exclusions to apply to situations where the insured has little or no connection with the person who committed the activities giving rise to the application of the absolute exclusion. In essence, they are holding that causation is not a factor to be considered over "clear and unambiguous" policy language.

Yet, at all times prior to these absolute exclusion developments, the exclusionary categories above applied to the conduct or resultant harm as caused by the "insured(s)." That is no longer the case and, in my opinion, is an unfair trade practice.

Since publication of my 2010 article on absolute exclusions, I have lectured and given webinars on the fact that the basis for many of the "absolute" exclusions is that the excluded exposure is supposed to be covered under other policies or not at all as to the *insured's conduct.* In other words, if you have an E&O policy, insureds should not look to the policy to cover them for typical directors and officers exposures, employment practices liability exposures, or even technology exposures, unless the policy is a package policy with several different hazards covered under the same form. (This is irrespective of whether the limits are segregated or aggregated together.) It should come as no surprise that almost every liability policy (except a workers compensation policy) excludes from coverage those claims that should be covered by a workers compensation policy. That is how exclusions traditionally were categorized. The evolution of absolute language, however, has changed the dynamic to the detriment of the insured and the insurance broker, who may be more likely to become the target of an E&O claim.

As referenced in an article published in *Coverage Opinion,*[3] the language "arising out of" is policy language that can cut both ways. If such language is found in an insuring agreement, it is going to be broadly interpreted, as rare as it is to find it there (for obvious reasons). What *has* become common, however, is the fact that "arising out of" language now appears in exclusionary language, especially with respect to specialty lines, and in a vast majority of policies today (with lawyers professional liability being a common exception). More on that potentially discriminatory practice later. Exclusions themselves, rather than being "narrowly construed," are being broadly interpreted beyond what anyone, in my opinion, would reasonably expect until too late (i.e., when a claim is submitted and denied).

Specifically, in the article, the author cited two cases, one in favor of the insured, the other for the insurer. Note the difference, the favorable-for-the-insured case stating,

> While an insurer benefits from the broadly interpreted "arising out of," when the phrase appears in an exclusion, the free lunch gets paid for when "arising out of" appears in an insuring agreement. In *Shamoun & Norman, LLP v. Ironshore Indemnity, Inc.,* No. 14-1340 (N.D. Tex. Oct. 28, 2014), the court held that a professional liability insurer was obligated to provide a defense to a law firm for a fee dispute, rejecting the insurer's argument that this was not the rendering or failure to render professional legal services. The court noted that a legitimate argument existed that non-specialized tasks, such as billing and fee setting, do not fall under the definition of professional legal services. But, in the case before it, a different outcome was possible, on account of the language of the insuring agreement: "arising out of the rendering of or failure to render Professional Legal Services." As the court put it: "While billing and fee setting may not be acts constituting 'professional services,' this does not answer whether they are acts 'arising out of professional services.'" The court held that, given the breadth of the phrase "arising out of," a defense was owed: "Under Texas law, the phrase 'arising out of'

[3]Randy Manloff, "'Arising Out Of:' The Policy Language That Cuts Both Ways," Coverage Opinions 3, no. 15 (November 5, 2014).

> means that there is simply a causal connection or relation, which is interpreted to mean that there is but for causation, though not necessarily direct or proximate causation." Therefore, despite being a fee dispute, if the claim had a "causal connection or relation" to the provision of professional legal services, a defense was owed.

Yet, for the benefit of the insurer, the author noted,

> the Florida federal court addressed a breach of contract exclusion, stating that the insurer "shall not be liable to make any payment for Loss in connection with a Claim made against an Insured … alleging, arising out of, based upon or attributable to any actual or alleged contractual liability of the Company or any other Insured under any express contract or agreement."
>
> The court noted that "arising out of" has been defined to preclude coverage for claims originating from, having its origin in, growing out of, flowing from, incident to, or having connection with a specified excluding circumstance. From there, the court held that "consistent with Florida case law, this Court finds that the phrase 'arising out of' as used in [the breach of contract exclusion] is unambiguously broad and precludes coverage for purported tort claims that depend on 'the existence of actual or alleged contractual liability' of an insured 'under any express contract or agreement.'"

Florida's broad interpretation of an exclusion is obviously not alone. As reported by David Thamann,[4]

> Insurance policies abound with the use of the phrase "arising out of." Some policies provide coverage for injuries and damage that arise out of a certain event; other policies exclude coverage for injuries and damages that arise out of a certain event….

[4]David Thamann, "Arising out of Means What?" NU Property360 (November 3, 2015).

Given how broadly "arising from" is applied, few policies now use that language where it benefits the insured, yet routinely use it where it benefits the insurer.

This calls into question several significant maxims of insurance law, including the following.

1. Whether or not such insurance policies should be enforced given the fact that it has long been held that insurance contracts are *contracts of adhesion* and may be *unconscionable* as a result

2. Whether or not such insurance policies violate the doctrine of *the reasonable expectation of the insured to be covered* for something that should be covered, but due to the broad interpretation of the absolute exclusion, is now not covered

3. Whether or not such insurance policies violate *fair claim practice regulations* universally prohibiting the misrepresentation of coverage and in turn constitute a violation of unfair trade practices

4. While not specifically a maxim, "wrongful act" may no longer be limited to the actions of the insured or anyone for whom the insured may be responsible. Many definitions of "wrongful act" have been worded in a manner so as to broaden the definition to include anyone who is "connected with" the event in issue. Thus, the definition is not limited to the insured(s) but other third parties, possibly for no reason other than to trigger an absolute exclusion.

But, more on the above comes later.

This article will cite over 30 decisions that have been made throughout the United States regarding absolute exclusions, as reported and summarized by prominent law firms. We will explore whether or not the maxims noted above can or should apply to stop this trend. And, it should be noted, some of the cases decided have been in favor of the insured, or the exclusions were properly limited to the

insured's actions and/or uninsurable hazards, while, of course, many other cases differed.

It should also be noted that absolute exclusions are not limited to specialty line policies. The concept has also affected general liability and other commercial casualty hazards.

Some History of the Absolute Exclusion Discussion

I will not say that this trend started with an editorial in a major law firm's monthly publication on appellate decisions of interest. That publication is Tressler, LLP's *Specialty Lines Advisory,*[5] an excellent monthly summary of important appellate decisions throughout the country. However, that editorial may have helped the concept along. Said commentary focused on a 2009 court decision enforcing a runoff exclusion, which provided,

> for Loss on account of any Claim *based upon, arising out of, or attributable* to any Wrongful Acts *where all or any part* of such acts were committed, attempted or allegedly committed or attempted subsequent to [date]....

The aforementioned editorial stated,

> The language that prevailed here should almost always be advocated by insurers and their counsel who assist them in the drafting process. One can only speculate whether the result would have been the same with the less absolute wording not containing the "where all or part of" phrase. Most assuredly, the insurer would not have fully prevailed using the simple "for" version of the exclusion. Nevertheless, in today's market, perhaps putting aside the "hard" financial institution and financial services D&O (directors and officers)/E&O (errors and omissions) markets, astute brokers and policyholder counsel will resist vigorously the "super absolute" language. Beauty, however, is truly in the eye of the beholder and, as an insurer's coverage lawyer, I prefer super absolute beauty!

Jump ahead 11 years to a guest article in *D&O Diary*,[6] where another attorney suggested that the way to save money on D&O liability insurance is for the coverages to become more restricted and less broad. A lengthy list of 22 suggested limitations included,

> Return to broader "based upon, arising out of" exclusion preamble language in lieu of "for" language....

New cases enforcing absolute exclusions are being decided even as this article is being written.

Absolute Exclusion Phrasing

One might ask, "What is the phrase that triggers the problem?" Some may think it is "directly or indirectly." The courts and follow-up commentaries say otherwise, instead focusing on "arising from," meaning "connected with." From there, the broad application began, first in reviewing that language as used in an insuring agreement favoring the insured. As reported by the *Claims Journal* in 2012,[7] "The 'arising out of' clause defines the required causal link between the uninsured vehicle and the injury. Insurers have consistently argued for a narrow interpretation of the phrase while policyholders have advocated for a broader reading."

Insurers later opted to ask for broad interrelation of such exclusions and often got what they wanted.

[5]Tressler LLP, "Joe says: When an Exclusion Applies Absolutely," Specialty Lines Advisory 5, no. 12 (July 2009): 2.

[6]John McCarrick and Paul Schiavone, "Guest Post: Is it Time to Revisit the Scope of D&O Coverage?" *The D&O Diary* (December 2, 2019).

[7]"Third Circuit Interprets 'Arising Out Of' Clause for UM Benefits Broadly," *Claims Journal* (June 6, 2012).

Well over 30 case decisions have looked at and decided on the enforceability of these exclusions since at least 2008. Several have gone against insurance companies. That is not to say that there are not anymore, but this author is only aware of approximately 30-plus decisions. Certainly, there could be more that involve policies other than specialty lines (i.e., executive liability such as directors and officers, employment practices liability, fiduciary liability, as well as professional liability of all kinds and possibly even product liability).

The Three (General) Types of Phrasing Used

There are three general wordings to keep in mind (while noting that there will be variations).

1. "Arising directly or indirectly, or in any way associated with <fill in the blank … committed by **any insured** …" (etc., and what an insured should expect and want to see)

2. "Arising directly or indirectly, or in any way associated with <fill in the blank>. However, this exclusion will not apply to where the Insured [was providing a professional service]…." (A carveback example. There are many other variations. Once again, something that an insured should expect and want to see.)

3. "Arising directly or indirectly, or in any way associated with <fill in the blank>." (Note the lack of any carveback or reference to the insured. These can be a problem for insureds and are accelerating in use).

The three aforementioned phrasings are in and of themselves interesting. What is even more interesting, however, is how they appear in various insurance policies. Some policies have a preamble before any exclusions are listed that simply states, "This policy does not provide any coverage nor any defense to any claim arising directly or indirectly from:…." Thus, all of the exclusions that follow are subject to the preamble, which is absolute in nature.

Another variation is to have each exclusion start out with absolute language, while some exclusions may refer to the insured, and others may not. Some exclusions may have a carveback, while others do not, and thus there is a mix throughout the exclusionary section as to exclusions that are limited to the actions of the insured and others that are not. In such a policy, the underwriting intent as to those exclusions that do not refer to the insured can be interpreted to exclude a far greater range of acts.

Another example is a policy that contains a carveback at the end of the exclusionary section. In other words, it may say words to the effect of, "Exclusions A, G, H, M, S, T, etc., do not apply where the insured is providing a professional service as a…." Thus, once again, the underwriting intent is clear as to those exclusions not mentioned in the carveback—those exclusions could bar coverage for a far broader range of acts.

Early Absolute Exclusion Cases

In June of 2010, *Insurance Journal's* MyNewMarkets published my three-part series on the evolution of the absolute exclusion and how courts were beginning to interpret them more broadly than may have been the original intent. It was suggested in that article that, originally, the language was chosen so as to make clear to the insured that there was another policy the insured could buy to insure the excluded hazard.

For instance, an insurance broker's errors and omissions (E&O) policy should not have to cover an employment practices claim against the insured. The brokerage should instead buy an employment practices liability insurance (EPLI) policy. Yet, unless the exclusion references the insured as being the perpetrator of the wrongful employment act, and in the absence of a carveback clearly stating that the exclusion won't apply where the insured brokerage was selling insurance or a bond to a customer, appellate cases began and are still now enforcing the applicability of the exclusion to apply where

a customer or any other third party is the perpetrator. Thus, if the insurance brokerage is sued for any matter remotely "connected with" an employment wrongful act, the brokerage may not be covered. This now suggests that the intent is no longer limited to the insured's actions, and the intent is not to cover any EPLI matter, no matter who was involved.

One might suggest the first case to test the enforceability of the foregoing was *Jackson v. Atlantic,*[8] a 2005 New Jersey case that ruled in favor of the insured insurance broker who allegedly didn't provide any pollution coverage to a landlord who was eventually sued by a tenant for exposure to lead. The landlord sued the broker, whose E&O insurer denied coverage due to an absolute exclusion for pollution, with no carveback nor any limitation restricting the exclusion to the activities of the insured. The court held, in finding coverage for the broker, that

> The appellate court affirmed the trial court's decision in favor of the broker, finding that the exclusion did not preclude coverage for the professional negligence action. The court specifically noted that the policy in question covered professional negligence for wrongful acts resulting from errors and omissions of the insured from services rendered as an insurance broker….
>
> The insurer argued that the exclusion in the policy specifically addressed the coverage question because it included language that excluded coverage for … any litigation or administrative procedure in which an Insured may be involved as a party; arising directly, indirectly, or in concurrence or in any sequence out of actual, alleged or threatened existence, discharge, dispersal, release or escape of "pollutants…."
>
> The court dismissed the concept that the "indirect" language contained in the pollution exclusion somehow supported the potential applicability of the pollution exclusion to the allegations of professional negligence. Finding that the origin of the pollution was irrelevant, the court focused on the claim in controversy, which involved professional negligence and not pollution stemming from the broker's premises or acts. The court further noted that the broker's (as the insured) reasonable expectations of coverage would also support a finding of coverage in this circumstance. Thus, the court summarily dismissed the insurer's arguments.

Similarly, in 2009, the US Court of Appeals for the Ninth Circuit, in deciding California law, ruled in *S.J. Amoroso Constr. Co. v. Executive Risk Indem., Inc.,* No. C 06-2572 SBA, 2009 U.S. Dist. LEXIS 116080 (N.D. Cal. Dec. 11, 2009). This case involved a D&O policy containing an absolute exclusion for contractual liability, with the court holding,

> an exclusion within a D&O (directors and officers) policy which precluded coverage for claims "arising from" liability "under any written or oral contract or agreement" did not bar coverage where the insured was not a party to the contract at issue and thus had no liability under it.

However, few favorable decisions for insureds have been seen since, including the aforementioned New Jersey and the Ninth Circuit for California, where rulings have since gone the other way.

In 2008, the case of *James River Ins. Co. v. Ground Down Eng'g*[9] was decided. This was the case that first got my attention. This case involved a Florida-based engineering firm, which, although not mentioned in the opinion, does 100 percent environmental testing

[8] *Jackson v. Atlantic,* No. A-1526-04T5F, 2005 N.J. Super. Unpub. LEXIS 262 (Super. Ct. App. Div. Oct. 26, 2005), as reported by Andrew S. Boris, Esq. of Tresslor, LLP (December 14, 2005).

[9] *James River Ins. Co. v. Ground Down Eng'g, Inc.,* 540 F.3d 1270 (11th Cir. 2008), as reported by Monica Mendes, Tressler Specialty: Line Advisory (2008).

of land (aka site 1 surveys). After failing to find any pollution at a particular site, the firm was sued when it was determined that it was wrong. James River denied coverage based on an absolute exclusion that was not limited to the acts of the insured and did not have any carveback for professional services. Florida is a strict adherent to the four-corners rule, a doctrine that states that, in the event of ambiguous terms, the court should rely on the relevant written instrument solely. In part due to this adherence, the trial court found that the exclusion was clear and unambiguous and ruled in favor of James River. Subsequently, an appellate court reversed the decision due to the fact that the engineering firm hadn't created the pollution and was only providing a professional service. In other words, Ground Down was not the cause nor the source of the pollution. That decision was reversed by a higher court based on the four-corners rule. The court held that causation was not relevant (a theory that has been followed by many states since).

In addition, the court briefly addressed the issue of illusory coverage. The court stated that other engineering services giving rise to claims would be covered, and, thus, the policy was not illusory. This argument is questionable given the fact that the insured only did environmental-related services. Other cases have resulted in rulings that coverage is not illusory if only one type of claim is covered—despite premium costs that are more in line with more complete and less limited coverage.

Many cases have since followed the concept that causation isn't a factor, leaving large potential gaps in one's policy and thus one's financial security. As my colleague Christopher Burand recently wrote,

> The goal of insurance is to restore the insured's financial situation, their balance sheet usually, to the exact amount less a deductible just prior to the loss. People need this protection when they suffer a large loss. When that protection is not provided, what happens?[10]

Lines of Business Particularly Impacted by Absolute Exclusions

The usage of absolute exclusions that are not limited to the actions of the insured exists in most types of specialty lines insurance policies. What is interesting is to what extent.

Those insuring hazards that seem to have the most exclusions that go beyond the activities of the insured are found in the following policies.

- Miscellaneous professional liability
- Directors and officers liability
- Insurance agent and brokers errors and omissions (especially)

When one looks at the vast number of exclusions not limited to the actions of the insured that exist in insurance agent and broker professional liability policies, it is rather extraordinary considering the industry's reliance on agents and brokers.

Many other hazard groups have a mix where some policies have a few absolute exclusions, and some policies have a few more.

What is interesting is the hazard group that has the fewest absolute exclusions for acts that arise from someone other than the insured. That group is lawyers, with accountants a close second. Some lawyers professional liability policies have no absolute exclusions involving a third party, as every exclusion refers to the "insureds" (a favorable approach for those insureds). In other words, attorneys need not worry about

[10]Chris Burand, "How 'You Have a Duty To read Your Policy' Language Can Wreck a Life," *Insurance Journal* (July 1, 2019).

working on a wrongful termination, a discrimination, or an environmental case, but an insurance broker may not have any coverage for selling an employment practices liability insurance or pollution policy due to an absolute exclusion with no carveback for simply selling or placing the coverage.

Representative Cases Involving Absolute Exclusions

What follows are cases mostly in the specialty lines arena. The language "arising from" also exists in other commercial and personal lines policies. Nonetheless, exclusions generally have followed one of three categories. There are those exclusions that exist because the nature of the claim is uninsurable, such as intentional or fraudulent acts. There may be exclusions that exist due to the fact that there are other policies to cover that hazard. Finally, there are exclusions that exist because the insurer simply does not want to cover that hazard, such as return of attorney fees or claims seeking return of commissions. Exclusions on losses deemed uninsurable as a moral hazard should be expected.

More concerning are those exclusions that are not limited to the actions of the insured and thus are resulting in claims being denied where one would reasonably expect there would be coverage. Certainly, that is the case with the *Ground Down* decision (*James River Ins. Co. v. Ground Down Eng'g,* 540 F.3d 1270 (11th Cir. 2008)) and many others that follow. These cases can be split into two groups: the first are those claim denials that were upheld despite not being limited to the activities of the insured, which can be harmful for those insureds.

The other category involves intentional or illegal acts by the insured. There should be no quarrel with this category, other than the fact that the breadth of the exclusion sets the precedent for the first type of claim denials that can be harmful for the industry.

Of course, there are some cases where the courts ruled in favor of the policyholder, but these are becoming less frequent.

The case reviews featured in this discussion are authored by attorneys who are acknowledged in the footnotes.

Case Summaries Favoring the Insurer for Acts of Anyone (Potentially Even Beyond the Insured) and/or Contrary to What a Reasonable Insured Would Expect To Be Covered

Pollution Exclusion in Engineers E&O Policy[11]

The underlying action involved a suit by a property owner against the insured site assessor (Ground Down) for alleged negligent completion of the assessment and negligent representations to the property owner when it was contracting to purchase the property. As a result, the property owner sustained damages arising from the environmental contamination at the site. Ground Down sought coverage from its professional liability insurer, which denied any defense or indemnity obligation based upon the errors and omissions (E&O) policy's pollution exclusion. The district court also found that it would be "unconscionable at best" to interpret the policy as excluding claims relating to "any form of pollution, regardless of causation." Upon appeal, the Eleventh Circuit noted the Florida Supreme Court's holding in *Taurus Holdings, Inc. v. U.S. Fid. & Guar. Co.,* 913 So. 2d 528 (Fla. 2005), where the court found that the phrase "arising out of" should be interpreted broadly, and it is broader than the phrases "caused by," "originating from," and "having a connection with." In light of this broad interpretation, the Court of Appeals found that "[a] thorough reading of the policy in this case shows the intended breadth of the exclusion and reveals that the

[11] *James River Ins. Co. v. Ground Down Eng'g, Inc.,* 540 F.3d 1270 (11th Cir. 2008), as reported by Monica Mendes, Tressler Specialty: Line Advisory (2008).

exclusion [applies to] the claim brought by [the property owner]." Specifically, the court noted that the exclusion precluded coverage for "any damages, claim or suit … arising out of pollution including damages for devaluation of property and requests that any insured or others 'monitor, clean up, remove, contain, treat, detoxify or neutralize or in any way respond to … the effects of pollutants, environmental impairments, contaminants….'"

The court further held that the alleged damages "arise directly out of the alleged discovered pollution and are covered explicitly by the exclusion." The court also reasoned that it was bound by the plain language of the policy, which provided that the exclusion applied regardless of whether the "cause for the injury or damage is the insured's negligent hiring … or wrongful act." The court interpreted this provision to mean that the exclusion applied regardless of whether the insured's conduct actually resulted in pollution. Accordingly, the Eleventh Circuit reversed and found in favor of the insurer.

Finally, in response to the argument that the policy provided illusory coverage, the court noted that any engineering claim not involving "pollution" would be covered, while ignoring the fact that the insured's operations, as per their application, was 100 percent pollution related.

Bankruptcy or Insolvency of Anyone in an Insurance Broker's E&O Policy[12]

This action involved the interpretation of an E&O policy issued by Westchester Fire Insurance Company (Westchester) to C.L. Frates & Company (Frates), a broker. The policy contained an exclusion for claims "arising out of" bankruptcy or insolvency. Frates was retained by its client to procure stop-loss coverage for it, which it placed with United Re. After issuing the stop-loss policy, United Re filed for bankruptcy protection. Learning of the bankruptcy filing, Frates investigated United Re and discovered that it was not an insurance company. It had been sued in Ohio and filed bankruptcy to stall the Ohio litigation. Based on these facts, Frates advised the client to move its stop-loss coverage to another insurer. Frates, however, had to reimburse the client for what it lost through the payment of higher deductibles. Frates tendered a claim to Westchester under its E&O policy, seeking reimbursement of the additional deductible cost. Westchester disclaimed any obligation to reimburse it on the basis that the claim arose out of the bankruptcy or insolvency of United Re.

The court asked whether a reasonable trier of fact could conclude that the claim "arose out of" United Re's bankruptcy or insolvency. As a preliminary matter, there was an issue as to whether United Re was insolvent or whether it filed bankruptcy as a litigation tactic. Oklahoma courts define the term "insolvency" to mean "an inability to pay debts as they become due."

Underlying Fraud in Title Agent's E&O Policy[13]

Darwin insured Zen Title, a title insurance agency, under a claims made and reported professional liability policy. One of Zen Title's clients was United General Title Insurance Company (UGT), for which Zen Title had responsibility for recording mortgages, deeds, and mortgage satisfactions and for paying fees associated with those recordings. Zen Title's responsibilities also including paying off mortgages on behalf of UGT and its customers in connection with mortgage refinancing transactions. During the policy period, UGT terminated its relationship with Zen Title and brought suit against the company and its three principals. The court rejected the insured's attempt to divorce the cause of action for negligence from its context

[12] *C.L. Frates & Co. v. Westchester Fire Ins. Co.,* 2013 U.S. App. LEXIS 18340 (Sept. 4, 2013), as reported by Michaela L. Sozio and Yvonne M. Schulte, Tressler, LLP (2013).

[13] *Bethel v. Darwin Select Ins. Co.,* 2013 U.S. App. LEXIS 23183 (8th Cir. Nov. 18, 2013), as reported by Traub, Liebeman, Strauss & Shresberry, LLP (November 22, 2013).

within the rest of the complaint. While the court agreed that the plaintiff could have filed a cause of action for negligence that had nothing to do with the alleged fraudulent scheme, the court could not ignore the actual allegations in the complaint. As the court explained, "Minnesota's notice pleading rules did not require UGT to identify the specific circumstances under which each failure to record occurred, and so UGT's claims could possibly be premised on unspecified failures to record that are unrelated to the fraudulent scheme. This argument underestimates the significance of what UGT actually included in its complaint."

Commingling Exclusion in Title Agents E&O Policy[14]

The insured, a title insurance agent, acted as the title and settlement agent for a real estate transaction in New Jersey. After the closing was postponed, the agent tried to return the loan proceeds to the mortgage lender. As part of that process, the agent received emails from individuals purporting to be representatives of the lender concerning the wire details for the return of the funds. Relying on the instructions provided, the agent transferred the loan proceeds of $480,750.96, only later to find out it was a scam. The US District Court for the District of New Jersey, applying New Jersey law, has held that an insurer does not need to cover more than $480,000 that an insured transferred pursuant to fraudulent instructions. The court determined that the circumstances implicated an exclusion that precluded coverage for loss that arose out of the theft or misappropriation of funds. The court disagreed and determined that the exclusion broadly encompassed conduct by the insured or a third party.

Pollution Exclusion in Insurance Company E&O Policy[15]

The (insurance) company was sued after denying coverage under a real estate pollution policy for costs incurred to clean up groundwater contamination. The insurance company tendered the pollution coverage action to the E&O insurer, which denied coverage based on an exclusion in the E&O policy for claims based on or arising out of pollution and "any dispute over the existence or absence of, or particular terms, conditions or amount of, insurance coverage" for pollution. (The insurer's application clearly disclosed premiums written for pollution policies it sold others in addition to its other lines of coverage—hence, premiums were paid on that volume.) The court agreed with the E&O insurer, holding that the pollution exclusion was unambiguous, and barred coverage for the pollution claim. The company argued that the E&O insurer waived or was estopped from relying on the pollution exclusion because it had not issued a coverage position for some years after the claim was tendered. The court disagreed, holding that the company had not alleged any facts showing that the E&O insurer intended to waive its coverage defenses or that the company had reasonably relied to its detriment on the absence of a coverage position. The court also dismissed the company's claim for reformation, finding insufficient allegations that the parties "intended" to cover pollution claims under the E&O policy. Interestingly enough, the insured's application disclosed its premium volume for sales of pollution policies to its customers, and premium was charged for that line item as a result.

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[14] *Authentic Title Servs. v. Greenwich Ins. Co.,* No. 18–4131 (KSH) (CLW), 2020 U.S. Dist. LEXIS 215018 (D.N.J. Nov. 17, 2020).

[15] *United Nat'l Ins. Co. v. Indian Harbor Ins. Co.,* No. 14–6425, 2015 U.S. Dist. LEXIS 12370 (E.D. Pa. Feb. 2, 2015), as reported by Karen L. Toto, Wiley, LLP (February 19, 2015).

Prior Acts Clause—Not Limited to the Wrongful Acts of the Insured Persons in a D&O Policy[16]

Two insured persons, executives at a bank, were sued by the bank's bankruptcy administrator for breaching fiduciary duties to the bank. They allegedly approved two tax return transfers to the bank's subsidiary in 2009 that were made when the bank was insolvent and thus violated the Florida Uniform Fraudulent Transfers Act. In November 2012, the administrator made a written settlement demand. After the demand was forwarded to the directors and officers (D&O) insurer, the insurer denied coverage based on the policy's prior acts exclusion. The exclusion provided that the insurer would not be liable for any claim "arising out of, based upon, or attributable to any Wrongful Act committed or allegedly committed, in whole or in part, prior to [November 10, 2008]."

On appeal, the court held that the prior acts exclusion barred coverage for the fraudulent transfer claims because the fraudulent transfer claims "arose from" wrongful acts that predated the policy's effective date. In so holding, the court noted that the exclusion's language, which barred coverage for any claim "arising out of" any wrongful act committed prior to the inception date of the policy, had a broad meaning. Although the transfers were made after the prior acts date, the underlying conduct rendering the bank insolvent—and the transfers fraudulent—occurred before the priors acts date. The court concluded that the fraudulent transfer claims "arose from" wrongful acts that predated the policy's effective date and thus fell within the scope of the prior acts exclusion.

[16] *Zucker v. U.S. Specialty Ins. Co.,* 856 F.3d 1343 (11th Cir. 2017), as reported by Bridgett A. Franklin, Brouse McDowell, Lexology, and others (September 12, 2017).

Medical Services and Bodily Injury Exclusion in Software Tech E&O[17]

The insured was a software development and data hosting company. It contracted to convert certain electronic medical records for a healthcare provider from one platform to another. Two years later, a patient sued the provider for malpractice, alleging that he was incorrectly prescribed a particular medication. The provider asserted a third-party claim for contribution and indemnification against the insured and other parties. The provider alleged that the insured improperly converted its electronic medical records. The insured sought coverage under a technology E&O policy, but its insurer declined coverage based on two exclusions. First, the court held that coverage was barred by an exclusion for any claim "based on or arising out of medical professional malpractice including, but not limited to, the rendering o[r] failure to render medical professional services, treatment or advice." The court noted that the phrase "arising out of" had a "broad, comprehensive … meaning." The court held that the exclusion for any claim "arising out of or resulting from: physical injury" barred coverage as well.

ERISA and ESOP Exclusions in Fiduciary Liability Policy[18]

The president and CEO of a company that provides trustee services to employee stock ownership plans (ESOPs) executed a stock purchase agreement on behalf of an ESOP. Because the company relied on a flawed valuation opinion to purchase the stock, the stock was overvalued, and the transaction resulted in a significant financial loss to the ESOP. The Department of Labor filed an action against the company, the president, and the ESOP alleging Employee Retirement Income Security Act

[17] *Jackson, Key & Assocs., LLC v. Beazley Ins. Co.,* No. 1:18-CV-00322-KD-C, 2018 U.S. Dist. LEXIS 215887 (S.D. Ala. Nov. 30, 2018), as reported by Edward R. Brown, Wiley, LLP (January 17, 2019).

[18] *Gemini Ins. Co. v. Potts,* No. 2:16-cv-612, 2020 U.S. Dist. LEXIS 124027 (S.D. Ohio July 15, 2020), reported by Ysabelle Reyes, Wiley, LLP (July 22, 2020).

(ERISA) violations. The exclusion stated that "This Policy does not apply to any Claim or Claim Expenses Arising Out Of any actual or alleged: J) Violation of or failure to comply with the … ERISA … or similar provisions of any Federal, State or local statutory law or common law." The court held that coverage was not illusory as long there was "at least one example to which coverage would apply." Accordingly, the ERISA exclusion barred coverage.

Premium Finance–Related Claims in Insurance Broker E&O Policy[19]

The insured agent was sued by one of his clients, who alleged that he lost more than $3 million due to a premium-financed life insurance agreement that the agent had brokered and that the agent made misrepresentations regarding future premium payments. The insurer defended the agent under a reservation of rights. The court held that a professional liability policy does not afford coverage for a lawsuit against an insurance agent because the suit fell within the policy's exclusions for claims based upon, directly or indirectly arising out of, or in any way involving premium finance mechanisms regarding future payments.

Products Exclusion in D&O Policy[20]

MRC Polymers, the insured entity, was in the recycled plastics business manufacturing plastic "flake" using a proprietary "Washline technology." It formed a limited liability company (LLC), MRH, to hold the intellectual property rights to the technology and another LLC (Operations) to hold its assets. An investor in the waste and recycling industries purchased the Washline technology from MRH and Operations as well as Washline equipment from MRC. The investor also entered into certain facility and equipment leases with MRC. The investor later became dissatisfied with the performance of the technology and equipment and sued MRH, Operations, and a principal associated with all the entities. The investor alleged fraudulent inducement, misrepresentation, contractual indemnification, and breach of contract.

MRC's insurer denied coverage for the lawsuits, relying on the products and services liability exclusion in a private company management liability policy, and filed a declaratory judgment action in Illinois state court. The exclusion barred coverage for "Loss for any Claim based upon, arising out of or in any way related to any actual or alleged Claim for a Wrongful Act by reason of or in connection with the efficacy, performance, health or safety standards and/or proprietary licensing rights for any services, products or technologies offered, promised, delivered, produced, processed, packaged, sold, marketed, distributed, advertised and/or developed by the Insured Entity (MRC)." The appellate court (and insurer) acknowledged that "if any part of the underlying complaint sets forth alleged facts that are within the scope of coverage, the duty to defend arises." And "if several theories of recovery are alleged in the underlying complaint against the insured, the insurer's duty to defend arises even if only one of several theories is within the potential coverage of the policy." The court disagreed with MRC's reading of the exclusion as applying only where MRC offered the product directly to the end user. The court noted the "extremely broad" language of the exclusion that clearly applied to preclude coverage.

Lack of Good Faith Exclusion in Claims TPA E&O Policy[21]

The insured acted as a third-party administrator (TPA) for an auto liability insurer. After a car accident involving an insured driver, the

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[19] *Columbia Cas. Co. v. Abdou,* No. 15cv80-LAB (KSC), 2015 U.S. Dist. LEXIS 169036 (S.D. Cal Dec.16, 2015), as reported by Jennifer A. Williams, Wiley, LLP (January 11, 2016).

[20] *Hanover Ins. Co. v. MRC Polymers, Inc.,* 2020 IL App. (1st) 192337 (Sept. 10, 2020), as reported by Aronberg Goldgehn (September 29, 2020).

[21] *American Claims Mgmt. v. Allied World Surplus Lines Ins. Co.,* No. 18-CV-925 JLS (MDD), 2020 U.S. Dist. LEXIS 161594 (S.D. Cal. Sept. 3, 2020), as reported by Edward R. Brown, Wiley, LLP (September 29, 2020).

injured victims made a settlement demand for the $30,000 policy limit. The TPA did not resolve the claim within the limit. The victims obtained a $21 million jury verdict and the right to proceed against the driver's insurer for bad faith. The insurer settled with the victims for $15 million and commenced arbitration against the TPA, ultimately obtaining an $18.5 million award. The TPA's E&O insurer denied coverage. Coverage litigation ensued. On cross-motions for summary judgment, the court ruled that the TPA's E&O policy did not cover the loss.

A federal district court has ruled that a TPA's professional liability policy does not afford coverage for a claim against the TPA arising from an excess judgment against the TPA's insurer-client. First, the court ruled that a "Claims Services Exclusion" applicable to claims "based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged … lack of good faith or fair dealing in the handling of any claim or obligation arising under an insurance contract or policy" barred coverage. After noting the prefatory language that was even broader than language requiring a "minimal causal connection or incidental relationship," the court ruled that the automobile insurer's assertions that the TPA carried out its claims handling obligations in bad faith were sufficient to implicate the exclusion. The court also concluded that only an "allegation" of bad faith was necessary, even if no bad faith was proved.

Second, the court applied a "Dishonest Act" exclusion, which barred coverage for any claim "brought about or contributed to by any dishonest or fraudulent act or omission or any willful violation of any statute, rule, or law by any Insured." In so doing, the court rejected the insured TPA's argument that it was not found to have committed fraud, concluding that the exclusion applied more broadly.

Prior and Pending Litigation Exclusion (Continuity) in D&O Policy[22]

The prior litigation exclusion in this case precluded coverage for any claim arising out of "prior or pending litigation or administration or regulatory proceeding, demand letter or formal or informal government investigation or inquiry." The insurer argued that the prior litigation exclusion applied since the underlying action was part of ongoing litigation commenced prior to the policy's "Continuity Dates" for alleged acts that occurred prior to the continuity dates and arose out of an arbitration award and judgment in which the employer's CEO was found to have engaged in fraud. The insureds argued that the arbitration demand was not "litigation" and that it was unrelated to the underlying litigation. The Ninth Circuit affirmed the district court's ruling in the insurer's favor. With respect to the prior knowledge exclusion, there was no coverage because an insured, albeit not necessarily the insureds seeking coverage, knew of the facts and circumstances from which the underlying suit derived. The court also agreed that the prior litigation exclusion precluded coverage for the underlying litigation because the suit arose out of a demand letter issued before the continuity date.

[22] *Woo v. Scottsdale In. Co.,* No. 14–56992, slip op. (9th Cir. Apr. 28, 2017), as reported by Danita L. Davis Sudac, Bad-Faith Bulletin (May 10, 2017).

Examples of Concerning Policy Language

While not yet appearing in any cases, there are other forms of potentially harmful policy language for insureds.

Three Concerning Policy Provisions for Insureds

Prior Act Language

"In consideration of the premium charged, it is agreed that the Insurer will not be liable to make any payment of Loss in connection with a Claim arising out of, based upon or attributable to any Wrongful Act committed or allegedly committed, in whole or in part, prior to …" where the definition of "Wrongful Act" is not limited to the insured(s).

Prior Pending Language

"IT IS AGREED that the Insurer is not obligated to pay Damages or Claim Expenses … or based upon or arising out of, either directly or indirectly from any legal actions, arbitration, or other adjudicative proceeding instituted and pending prior to the Effective Date of this Policy, **whether or not any Insured was named as a party in such legal action, arbitration, or other adjudicative proceeding prior to the Effective Date of this Policy."** (Emphasis added.)

Absolute Bodily Injury Exclusion with No Emotional Distress Carveback in an Employment Practice Policy

"It is understood and agreed that Clause 3, EXCLUSIONS, of the Employment Practices Liability Coverage Section is amended by deleting Exclusion (f) in its entirety and replacing it with the following: (f) alleging, arising out of, based upon or attributable to bodily injury, sickness, disease or death of any person, or damage to or destruction of any tangible property, including the loss of use thereof;…" (How can one claim to cover employment practices liability insurance (EPLI) claims when the resultant damage is excluded? Almost all damages claimed in an EPLI case are for emotional distress.)

Case Summaries Favoring the Insurer Involving Acts or Hazards Inconsistent with the Hazard To Be Insured (i.e., the Hazard Is Insurable on Another Type of Form) or Not Insurable

What follows are cases with which insureds should generally have no quarrel. However, what is lacking in the policy forms themselves is the expected severability language that one often finds and exclusions that would thus provide coverage to an innocent insured. In addition, with respect to the D&O liability decisions involving contractual exclusions, note that in many D&O policies, especially for privately held corporations, there are coverage grants and exclusions that are unique to the individual directors and officers, as opposed to the corporate entity. For instance, usually the individual directors and officers have more coverage than the entity for causes of action such as breach of contract, product liability, etc., but those causes of action would be excluded as to the corporate entity, which is usually an insured in a privately held corporate

D&O form. Thus, in the cases below, it appears that the individual directors and officers were not covered for breach of contract when normally they would in fact have been covered under many other forms.

Also true, especially in lender exposures, is the fact that often D&O liability coverages are offered and provided in conjunction with a separate policy for professional liability. This may not always be the case, and some D&O policies do have carvebacks in their professional services exclusions that would provide coverage to an individual director or officer when acting in a supervisory role. This is something usually found, again, in private company forms.

Fee Dispute in Attorney's Professional Liability Policy[23]

The court held that a professional liability insurer was obligated to provide a defense to a law firm for a fee dispute, rejecting the insurer's argument that this was not the rendering of or failure to render professional legal services. Given the breadth of the phrase "arising out of," a defense was owed: "Under Texas law, the phrase 'arising out of' means that there is simply a causal connection or relation, which is interpreted to mean that there is but for causation, though not necessarily direct or proximate causation." Therefore, despite being a fee dispute, if the claim had a "causal connection or relation" to the provision of professional legal services, a defense was owed.

Invasion of Privacy D&O Policy[24]

A claim against a corporation was denied under its D&O policy where the court granted summary judgment in favor of the insurer, holding that an invasion of privacy exclusion barred coverage for the lawsuit. The invasion of privacy exclusion excluded from coverage any claim "based upon, arising out of, or attributable to any actual or alleged defamation, invasion of privacy, wrongful entry and eviction, false arrest or imprisonment, malicious prosecution, abuse of process, assault, battery or loss of consortium." The court rejected the claimants' argument that an invasion of privacy is not an element of a Telephone Consumer Protection Act (TCPA) claim and ruled, instead, that the allegations clearly included alleged privacy violations under the TCPA because the class argued that the insured's texts violated their privacy.

Contract Exclusion in Educator's Professional Liability[25]

An educator's professional liability insurance policy did not afford coverage for a lawsuit against an insured schoolteacher accused of sexually abusing a student. Specifically, the court held that the allegations of sexual abuse—despite occurring in part on school premises—did not constitute "educational employment activities" necessary to trigger coverage.

Contract Exclusion in D&O Policy[26]

Land Resource LLC (LRC) built residential subdivisions in the southern United States. Robert Ward was LRC's CEO. The municipalities in which LRC built the subdivisions required LRC to obtain surety bonds to guarantee performance. Beginning in 2003, Bond-Lexon issued subdivision bonds to LRC. In connection with the issuance of the bonds, Ward and LRC executed a general agreement of indemnity (GAI), in which LRC and Ward indemnified Bond-Lexon from claims, demands, and liabilities that the

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[23] *Shamoun & Norman, LLP v. Ironshore Indem., Inc.,* 56 F. Supp. 3d 840 (N.D. Tex. 2014), as cited by Randy Manloff, "'Arising Out Of:' The Policy Language That Cuts Both Ways," Coverage Opinions 3, no. 15 (November 5, 2014).

[24] *Horn v. Liberty Ins. Underwriters, Inc.,* No. 9:18-cv-80762 (S.D. Fla. May 30, 2019), as reported by Edward R. Brown, Wiley, LLP (June 7, 2019).

[25] *Horace Mann Ins. Co. v. Barney,* No. 2:17CV00016, 2018 U.S. Dist. LEXIS 60318 (W.D. Va. Apr. 10, 2018), as reported by Danielle Barondess, Wiley, LLP (April 25, 2018).

[26] Unpublished 11th Circuit opinion (Oct. 5, 2015), as reported by Keven LaCroix, *The D&O Diary* (November 3, 2015).

surety company might incur as a result of having executed the bonds. In the summer of 2008, LRC stopped making progress on the subdivision construction. The municipalities sent Bond-Lexon notices of default. The bonds were paid. Bond-Lexon filed a two-count federal court complaint against Ward and other directors and officers of LRC, alleging (1) a breach of the contractual duty to indemnify under the GAI and (2) negligence by Ward and other individual defendants. Ward submitted the lawsuit as a claim to LRC's D&O insurer. The insurer denied coverage for the claim in reliance on the insurance policy's contractual liability provision.

The Eleventh Circuit, applying Florida law, held that a D&O insurance policy's contractual liability exclusion precluded coverage for negligence claims asserted against persons insured under the policy. The contract exclusion was written with a broad "based upon, arising out of" preamble wording. The decision highlights concerns about the use of the broad preamble in D&O insurance policies' contractual liability exclusion.

Lending Services Exclusion in Bank's D&O Policy[27]

A "Lending Services" exclusion in a D&O policy barred coverage for a claim alleging that a policyholder wrongfully recorded and refused to release certain security interests. The property owner filed suit against the bank and its officers, seeking a declaratory judgment that the liens were fraudulent and asserting various state law claims. Those claims were premised on allegations that the bank and its officers improperly placed fraudulent liens on the owner's property and that they refused to release those liens unless they were paid a certain sum of money. In a coverage action that followed, the insurer argued that there was no coverage for the property owner's claims because the policy excluded claims "based upon, arising from, or in consequence of the [insured's] performing or failure to perform … Lending Services." In so ruling, the court held that an injury is "based upon, arises from, or is in consequence of" certain conduct if there is a causal connection between the two, rejecting an insured's argument that proximate causation is required. The policyholder, a bank, made several loans to its customer so that the customer could purchase a franchise and open a restaurant. The customer entered into a lease with a property owner and made renovations to the property, and the bank secured its loans with liens on the restaurant equipment, the franchise, and the lease. The customer subsequently defaulted on its bank loans, franchise agreement, and lease, and the property owner terminated the lease and identified another company to take over the franchise and operate the restaurant. That company eventually shut down its operation of the restaurant, however, when the bank refused to release its liens.

Lending Services in Bank's D&O[28]

The investors' allegation that plaintiff Westport National Bank used incoming funds to pay its own fees and to sustain its custodial business and continue to generate its fees implicated a "profit" and a "financial advantage to which [Westport] was not entitled." The court's final ground for denying coverage was the policy's "Personal Profit and Advantage Exclusion" (often called the profit/advantage exclusion). A form of the profit/advantage exclusion is found in most D&O policies, but the language can vary greatly. In the language of the exclusion in the professional liability policy before the court, the exclusion eliminated coverage for loss "based upon, arising out of, or attributable to [the] Insured gaining in fact any personal profit, remuneration or financial advantage to which such Insured was not legally entitled."

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[27] *Western Heritage Bank v. Federal Ins. Co.,* 938 F. Supp. 2d 1219 (D.N.M. 2013), as reported by Wiley, LLP (May 2013).

[28] *Associated Cmty. Bancorp., Inc. v. St. Paul Mercury Ins. Co.,* 2014 NY Slip Op 04697, 118 A.D.3d 608, 989 N.Y.S.2d 15 (App. Div. 1st Dept.), as reported by John Green, Farella, Braun, & Martell (July 21, 2014).

Profit/Advantage Exclusion in D&O Policy[29]

A bank caught up in the Madoff debacle had no coverage, not even for defense costs, for investor claims. A form of the profit/advantage exclusion is found in most D&O policies, but the language can vary greatly. The exclusion in the professional liability policy before the court eliminated coverage for loss "based upon, arising out of, or attributable to [the] Insured gaining in fact any personal profit, remuneration or financial advantage to which such Insured was not legally entitled." One would assume that the proviso that the advantage or profit must be gained "in fact" requires some finding, or at least a presumption, that the excluded conduct was not simply alleged but actually ("in fact") occurred. The court found, however, that the mere allegations by the investors that the insured was motivated by a profit or advantage to which it was not entitled triggered the exclusion. This same "profit/advantage" exclusion with an "in fact" trigger can be found in some D&O policies currently sold to public or private corporations. However, the more typical—and more favorable—version of the exclusion limits its application to situations where there has been a "final adjudication" of the excluded conduct.

Securities-Related Exclusion in Private Company D&O Policy[30]

The insurer issued a management liability policy with a D&O coverage part to a company indirectly owned by the plaintiffs based on their ownership interests in certain closely held companies. In 2014, the plaintiffs entered an agreement to sell their interests in the insured company to a separate holding company. The holding company filed suit against the plaintiffs, alleging they made false representations during negotiations and in the purchase agreement. The plaintiffs sought coverage under the policy as insured directors and officers of the company, which the insurer denied. The court has held that a broadly worded securities exclusion bars coverage of claims "incidental" to alleged misrepresentations made in connection with the sale of securities. The court next reviewed the policy's securities exclusion, which barred coverage for any claim "based upon, arising out of or in any way involving … the actual, alleged or attempted purchase or sale, or offer or solicitation of an offer to purchase or sell, any debt or equity securities." The court relied on the broad "arising out of" language to conclude that "[a] claim need only bear an incidental relationship to the described conduct for the exclusion to apply." It held that even if, as the plaintiffs argued, at least one of the allegations was not "caused by" the sale of their interests in the company, "all of the allegations bear, at the very least, an incidental relationship to the sale." The court also held that an exception to the exclusion that restored coverage for claims "based upon, arising out of or in any way involving … private[]placement transaction[s] exempt from registration under the Securities Act of 1933" did not apply. The Act exempts from registration "transactions by an issuer not involving any public offering," and since the plaintiffs merely resold previously issued securities, they did not constitute "issuers" under the Act.

Securities Exclusion in Private Company D&O Policy[31]

Colorado Boxed Beef Co. Inc. (CBB), a private company, and four of its directors and officers were sued in Polk County, Florida, by former holders of CBB securities who had sold their shares to three of the four CBB officers and directors as part of a prior stock purchase agreement transaction on or about April 1, 2015. The sellers alleged that the CBB directors and officers made misrepresentations and omissions of material facts relating to factors that

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[29] *Associated Cmty. Bancorp., Inc. v. St. Paul Mercury Ins. Co.,* 2014 NY Slip Op 04697, 118 A.D.3d 608, 989 N.Y.S.2d 15 (App. Div. 1st Dept.), supra.

[30] *Gleason v. Markel Am. Ins. Co.,* Civil Action No. 4:17-CV-00163, 2018 U.S. Dist. LEXIS 11608 (E.D. Tex. Jan. 24, 2018), as reported by Danielle Barondess, Wiley, LLP (January 30, 2018).

[31] *Colorado Boxed Beef Co., Inc. v. Evanston Ins. Co.*, No. 19–10326 (11th Cir. 2019), as reported by Margaret Thomas, Wiley, LLP (June 2, 2019).

deflated CBB's stock price to the advantage of the directors and officers who bought the devalued shares. Specifically, the sellers alleged misrepresentations by those directors and officers and in the form of corporate theft, excessive compensation, usurpation of corporate opportunities, and self-dealing. Through this fraudulent conduct, the sellers alleged that the directors and officers acquired the CBB shares with CBB's funds rather than with their own money. The court held that an exclusion for claims "based upon, arising out of or in any way involving" the sale of securities extended to allegations of self-dealing and corporate theft despite the insureds' contention that they could stand alone from the excluded securities claims. In so holding, the court found that these allegedly wrongful acts were the means by which the insureds allegedly accomplished the excluded securities fraud. While the insureds have filed an appeal in the Eleventh Circuit, the district court's willingness to apply the exclusion to arguably independent wrongful acts counsels policyholders to carefully analyze the exclusions, including the preamble language, contained in their D&O policies. In addition, although the *Colorado Boxed Beef* opinion focused solely on the construction and application of a D&O policy, the underlying plaintiffs' claims may have been covered under a seller-side representations and warranties policy tailored to the disputed transaction, had such a policy been procured. Alternative coverage options, such as representations and warranties policies, should be considered in order to avoid potential gaps in coverage where broad exclusions may defeat coverage under other types of insurance.

Specific Litigation Exclusion in D&O Policy[32]

The excluded litigation involved an allegation that an individual had agreed to bribe the governor of Illinois in exchange for his support of certain legislation. The excluded litigation resulted in a $78 million judgment. In the underlying case, the company and its directors were alleged to have acted to conceal assets of the company from the creditors in the excluded litigation. The insureds argued that because the underlying litigation involved "some facts and allegations" relating to the excluded litigation, as well as allegations relating to funds not connected to the excluded matter, the exclusion should not apply. The exclusion provided that "[t]he Insurer shall not be liable to make any payment for Loss arising out of or in connection with any Claim made against any Insured alleging, arising out of, based upon or attributable to, directly or indirectly, in whole or in part, the following litigation[.]" The excluded litigation involved an allegation that an individual had agreed to bribe the governor of Illinois in exchange for his support of certain legislation. The court rejected that argument, holding that the exclusion barred coverage and noting that the underlying matter need only arise out of the excluded matter "in part." The court explained that "[t]he exclusion provision … did not require that litigation be identical to the [excluded matter] to be excluded from coverage[;] litigation merely had to arise from or be based in part on the [excluded matter]."

Social Media Fraudulent Transfer Exclusion in Accountant's E&O Policy[33]

A third party compromised the client's email server and sent fraudulent email requests for vendor payments to the insured. The insured completed the transactions, wiring more than $500,000 to bank accounts presumably controlled by the third party. After the loss was discovered, the client blamed the insured, and the insured sought coverage under its professional liability policy. The insurer denied coverage based on a policy exclusion barring coverage for "any damages or claim expenses, for any claim … based upon or arising out of the actual or alleged theft, misappropriation,

[32] *RSUI Indem. Co. v. Worldwide Wagering, Inc.,* No. 17-CV-01690, 2017 U.S. Dist. LEXIS 109993 (N.D. Ill. Jul. 17, 2017), as reported by Alexander Merritt, Wiley, LLP (July 24, 2017).

[33] *Accounting Res. Inc. v. Hiscox, Inc.,* No. 3:15-cv-01764 (JAM), 2016 U.S. Dist. LEXIS 135450 (D. Conn. Sept. 30, 2016), as reported by Wiley Executive Summary (November 22, 2020).

commingling, or conversion of any funds, monies, assets, or property." The insured then filed an action against the insurer for breach of contract. The court granted an insurer's motion to dismiss a breach of contract claim by an accounting firm, holding that the firm's professional liability policy's exclusion for theft, misappropriation, commingling, or conversion of funds precluded coverage for a claim against the insured for completing fraudulently requested transfers of funds. The court held that the exclusion was unambiguous and precluded coverage for the claim. The insured argued that the exclusion barred coverage only for theft, misappropriation, commingling, or conversion of funds by the accounting firm or its employees and not for the negligence of the insured in contributing to or failing to prevent those acts by others. The court concluded, however, that the exclusion contained no limitation regarding who must engage in the theft, misappropriation, commingling, or conversion, and, as a result, the exclusion applied regardless of who engaged in those acts. According to the court, the fact that other exclusions (e.g., the intentional acts exclusion) did specify to whose acts the exclusion applied supported its conclusion, because the parties plausibly could have drafted a similar limitation on the theft of funds exclusion.

Pollution Exclusion in Commercial Umbrella Policy[34]

The subject policy was issued by Great American to U.S. Concrete and provided commercial umbrella insurance coverage. Eastern Concrete Materials, Inc.—a wholly owned subsidiary of U.S. Concrete—was one of more than 60 entities named as insureds under the umbrella policy, which provided protection over and above a commercial general liability (CGL) policy issued by ACE American. Payment and defense obligations were outlined within the Great American umbrella policy, and an absolute pollution exclusion specifically provided a preamble as follows.

> The insurance does not apply to: ...
>
> L. Any liability, including but not limited to settlements, judgment, costs, charges, expenses, costs of investigations, or the fees of attorneys, experts, or consultants, arising out of or in any way related to....

This case represents a broad application of a pollution exclusion. While the word "pollutant" may connote for most a gray haze hanging over an industrial factory or the entry of toxic chemicals into a water supply, the location of even an innocuous substance may be held to impact the definition, such that it constitutes a "pollutant" in some contexts. Here, the court looked to the ultimate effect of the disbursement. While the particles were natural in form and harmless in their intended environment, they produced destructive results upon displacement.

Case Summaries Favoring the Insured

The following are in addition to *Jackson v. Atlantic,* No. A-1526-04T5F, 2005 N.J. Super. Unpub. LEXIS 262 (Super. Ct. App. Div. Oct. 26, 2005).

Contract Exclusion D&O[35]

A bond insurer sued to collect under the guarantee provisions of the bond. The court noted that "arising out of" has been defined to preclude coverage for claims originating from, having its origin in, growing out of, flowing from, incident to, or having connection with a specified excluding circumstance.

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[34] *Great Am. Ins. Co. v. ACE Am. Ins. Co.,* No. 4:18-CV-114-A, 2018 U.S. Dist. LEXIS 68022 (N.D. Tex. Jul. 10, 2018), as reported by Carlton, Fields, Joden & Burt (July 30, 2018).

[35] *Shamoun & Norman, LLP v. Ironshore Indem., Inc.,* 56 F. Supp. 3d 840 (N.D. Tex. 2014), as reported by Randy Manloff, "'Arising Out Of:' The Policy Language That Cuts Both Ways," Coverage Opinions 3, no. 15 (November 5, 2014).

From there, the court held that, "consistent with Florida case law, this Court finds that the phrase 'arising out of' as used in [the breach of contract exclusion] is unambiguously broad and precludes coverage for purported tort claims that depend on 'the existence of actual or alleged contractual liability' of an insured 'under any express contract or agreement.'"

Contract Exclusion in Product Design Firm E&O Policy[36]

DVO designs and builds anaerobic digesters that use microorganisms to break down biodegradable materials to create biogas. DVO entered into a contract with WTE-S&S AG Enterprise LLC under which DVO was to design and build an anaerobic digester to be used to generate electricity from cow manure. WTE sued DVO for breach of contract, alleging that DVO failed to fulfill its design duties, responsibilities, and obligations in that it allegedly did not properly design substantial portions of the structural, mechanical, and operational systems of the anaerobic digester, resulting in substantial damages to WTE.

DVO argued that the breach of contract exclusion was so broad as to render the E&O insurance illusory and therefore could not be enforced to preclude the duty to defend. The Seventh Circuit rejected the district court's conclusion that coverage was not illusory because the policy, even with the exclusion, still provided coverage for third-party claims. The appellate court noted that the problem with the district court's conclusion was that "the language in the exclusion at issue here is extremely broad. It includes claims 'based upon or arising out of' the contract, thus including a class of claims more expansive than those based upon the contract."

Bodily Injury Exclusion in Public Officials Form[37]

A prison guard assaulted a prisoner in 2004. The prisoner eventually died as a result of injuries sustained in the assault. At the time, however, the coroner wrongly determined that the prisoner died of a seizure disorder. In 2008, the county reopened the investigation into the prisoner's death, and the coroner concluded that it was a homicide. The prisoner's family filed a civil action against the county government and several police officials. The court ruled that the bodily injury exclusion did not preclude coverage for a wrongful death suit, reasoning that the death did not cause the alleged wrongful conduct and therefore did not "arise out of it." The court considered whether the claims arose out of "Bodily Injury" as defined in the second policy. The court found that the exclusion was inapplicable to all but one of the counts in the complaint. According to the court, "arising out of" under Ohio law meant "cause or contribute to." While the definition of "Bodily Injury" plainly included "death," the court reasoned that the prisoner's death did not cause the wrongful acts; rather, the wrongful acts caused the death.

Bodily Injury Exclusion in CGL[38]

The appellate division concluded that the assault-and-battery exclusion, which used the phrase "based on," "applies to claims, demands or suits where 'assault and Battery' forms or serves as the claim foundation." However, the court noted that New Jersey case law suggests that "an injury can have several proximate causes, and when one cause is excluded under the policy, it does not necessarily mean all causes of the injury

[36] *Crum & Forster Specialty Ins. Co. v. DVO, Inc.,* 939 F.3d 852 (7th Cir. 2019), as reported by Christina Gallo, Esq., Carlton Fields (November 7, 2019), and by Kevin LaCroix, *The D&O Diary* (September 24, 2019).

[37] *Clarendon Nat'l Ins. Co. v. Lexington Ins. Co.,* 312 F. Supp. 3d 639 (N.D. Ohio 2018), as reported by Matthew Beato, Wiley, LLP (September 25, 2018).

[38] *C.M.S. Inv. Ventures, Inc. v. American European Ins. Co.,* No. A-2056-17T3, 2019 N.J. Super. Unpub. LEXIS 1215 (Super. Ct. App. Div. May 28, 2019), reported by Timothy Carroll and Anthony Miscioscia, White & Williams, LLP (May 31, 2019).

are excluded." Thus, because the insured's tenant's claim was not "based only on the sexual assault" and, instead, sounded in premises liability, the assault-and-battery exclusion did not apply to preclude coverage. Notably, the appellate division stated that exclusions using the phrase "arising out of," instead of "based on," may "increase[] the type of claims subject to the exclusion." Notwithstanding its finding of coverage, the appellate division in C.M.S. also held that the CGL insurer was "estopped from denying coverage" because it waited 20 months to disclaim coverage after it received notice of the tenant's claim against the insured.

Contract Exclusion in D&O Policy[39]

In determining whether this exclusion precluded coverage for Amoroso, the court noted that, in the underlying action, Mauna Kea alleged that Amoroso made negligent or intentional misrepresentations that induced Mauna Kea to contract with DAP. Mauna Kea's theory of liability depended on the fact that Amoroso was not a party to the construction agreement between Mauna Kea and DAP and, as a result, was not liable under the contract. Accordingly, to that extent, the court found that Amoroso's liability in the underlying action was not liability under a contract or agreement and, thus, the contract exclusion within the D&O policy did not bar coverage for Amoroso. The Ninth Circuit Court of Appeals, applying California law, held that an exclusion within a D&O policy that precluded coverage for claims "arising from" liability "under any written or oral contract or agreement" did not bar coverage where the insured was not a party to the contract at issue and thus had no liability under it.

Pollution Exclusion in a CGL Policy[40]

In May 2006, Zhaoyun Xia fell ill after moving into her new townhouse. By December of that year, it was discovered that an exhaust vent had been negligently attached to a water heater and was discharging carbon monoxide into Xia's basement. Xia notified the townhouse's construction company, which eventually assigned Xia its rights under a CGL policy. After years of being denied coverage under the policy's absolute pollution exclusion, Xia sued the insurer for indemnification, bad faith, and violation of the state's Consumer Protection Act and Insurance Fair Conduct Act. The court held that, even if a loss is caused by an excluded pollutant, there may still be coverage if the efficient proximate cause of the loss is a covered occurrence. The Xia opinion, however, makes clear that, even in the case of excluded pollutants, the insurer must ask if the efficient proximate cause is a covered peril, like negligence. If the answer is yes, there may be coverage.

Application Warranty Exclusion[41]

The insured, an insurance company, completed an application to renew its D&O policy. The application asked, "Has the Applicant experienced changes to its Board of Directors or to its Key Executives over the past 12 months?" The insured responded, "No." In fact, the insured had terminated its president and chief executive officer and hired a new chief operating officer before completing the application. The insurer issued the policy. During the policy period, the insured provided notice of counterclaims in a lawsuit and arbitration alleging business disparagement and defamation, among other allegations, against certain insured directors and officers. The US

[39] *S.J. Amoroso Constr. Co. v. Executive Risk Indem., Inc.,* 2009 U.S. Dist. LEXIS 116080 (N.D. Cal. Dec. 11, 2009), as reported by Monica Mendes, Tressler, LLP (2009).

[40] *Xia v. ProBuilders Specialty Ins. Co. RRG,* 188 Wash. 2d 171, 400 P.3d 1234 (2017), as reported by Perkins Coie (June 2, 2017).

[41] *Columbia Lloyds Ins. Co. v. Liberty Ins. Underwriters, Inc.,* No. 3:17-CV-5, 2018 U.S. Dist. LEXIS 53730 (S.D. Tex. Mar. 30, 2018), as reported by Emily S. Hart, Wiley, LLP (April 23, 2018).

District Court for the Southern District of Texas has held that an exclusion contained in the application incorporated into the policy barring coverage for claims "based upon, arising out of or in connection with" misstatements in the application did not apply because the misstatements at issue, regarding a change in the insured's executive leadership, were not the "but for" cause of the claimant's alleged damages.

Professional Services Exclusion in D&O Policy[42]

In 2014, Timothy Byrne and Robert Bolt, acting as representatives of the Board of Trustees for the Plumbers and Pipefitters Local 51 Pension and Annuity Funds, brought suit against Wellesley Advisory Realty Fund I, LLC (WARF), alleging that WARF had "mismanaged and squandered money" that the funds had invested in that entity. In the underlying action, the funds alleged that they invested $5 million with WARF, which WARF subsequently used to invest in various real estate projects, including "The Stone House," a hotel in Little Compton, Rhode Island; a residential condominium in Newport, Rhode Island; and a housing development in North Attleboro, Massachusetts. Based on these allegations, the funds brought a claim alleging that WARF was negligent in overleveraging the properties in excess of their value, failing to pay property taxes, and retaining income from the properties for its own use.

The First Circuit Court of Appeals recently upheld a decision establishing coverage for a lawsuit filed by pension funds investors against an investment manager for allegedly mismanaging and squandering the pension funds' investments. Massachusetts law imposes a significant burden on an insurer to demonstrate that policy exclusions apply to bar coverage for claims that would otherwise be covered under a liability policy. It is also a decision that should be of interest to the investment management community because it suggests that many of the exclusions regularly relied upon by insurers to disclaim coverage for investment losses should be treated with a healthy dose of skepticism.

Commentary

Even when a policyholder "wins," significant money must be expended to enforce their coverage rights. Certainly, the insurance company itself also must expend significant amounts of money in asserting its exclusionary language. This is unsustainable from an actuarial perspective. Claims against policyholders are actuarially determined. However, what may not be taken into consideration in the formula is unallocated loss adjustment expense. This is money spent by insurance companies to prosecute a declaratory relief case for no coverage and/or defend a bad faith case for denying same. When this happens with significant frequency, the insurance companies are acting outside the actuarial model, as these expenses are generally not included in the actuarial analysis to set pricing for policies. One cannot make a profit if they are consistently acting outside the actuarial model.

Policyholders too must spend significant sums of money to defend or allege coverage rights. Even when they win, they may lose. If a bad faith cause of action is dismissed, the insured is only entitled to the coverage that should have been provided, and they often do not get their attorney fees for asserting their rights. Thus, it would not be uncommon to spend several hundred thousand dollars to assert their coverage rights only to get coverage benefits that are significantly less.

[42] *Scottsdale Ins. Co. v. Byrne,* 913 F.3d 221 (1st Cir. 2019), as reported by Steven P. Wright, K&L Gates, Lexology.com (February 7, 2019).

Public Policy Issues and Insurance Maxims: Do They and Should They Apply Regarding Absolute Exclusions?

Several public policy issues and insurance maxims are relevant to the discussion of absolute exclusions. Some involve duties of insureds, while others involve regulatory aspects of the industry.

The Duty To Read the Policy

There are many decisions throughout the United States that are now looking at the duty of an insured to read the policy. Even in the event that they do closely read their policies, would any "civilian" policyholder realize how a court would interpret the intent of the policy? Only the court can determine the intent. Policyholders, other than coverage lawyers, will have difficulty knowing how the courts might interpret an absolute exclusion. Thus, the only time an insured learns that there is a problem is after it has submitted the claim, when it is expecting assistance. This is not a time anyone wants any surprises.

That also begs the question as to whether or not every policyholder will now have to seek the advice of counsel to review the policies they are thinking of buying or have purchased to determine whether or not they are properly covered. That would be cost prohibitive for most and anticonsumer to some extent. The industry would benefit from regulators examining this problem.

Insurance Policies as Contracts of Adhesion

It has long been held that insurance contracts are considered contracts of adhesion. According to the International Risk Management Institute, Inc.,[43] a contract of adhesion is a contract between two parties where the terms and conditions are drafted by the party with superior bargaining power (typically a business) and the other party (typically a consumer) has little or no ability to negotiate more favorable terms. As a result, the consumer is placed in a take-it-or-leave-it position. Courts carefully scrutinize adhesion contracts and will sometimes void certain provisions on the basis that the provisions are unconscionable and are the product of unequal bargaining power. One has to ponder why that argument has not been raised regarding absolute exclusions.

A posting placed at UpCounsel.com[44] notes that courts will rule in favor of the policyholder in many cases involving adhesion contracts, but not always. This usually happens because there is a misinterpretation of the terms and there are no negotiations between the parties before the lawsuit. Yet, every court in interpreting absolute exclusions has found that the exclusions are clear and unambiguous, at least to the courts and insurers' coverage lawyers. Would those states following the four-corners rule consider the adhesion argument? Of course, that also begs the question as to whether or not a policyholder would spot the "clarity" and be capable of financing a fight when they are already defending a lawsuit on their own. Interestingly enough, the attorneys at Blank-Rome wrote in 2018[45] that

> at least one insurer[] has attempted to do just that by including an interpretation in the conditions section of a preprinted professional liability policy that upends, and materially changes a number of entrenched and important interpretive guideposts. In doing so, the insurance company was hoping that any potentially ambiguous provision will automatically, and by stipulation, be determined in the insurance [company's] favor, and not be subject to any authorship of the

[43] *Glossary of Insurance and Risk Management Terms,* International Risk Management Institute, Inc.

[44] "Adhesion Insurance Definition: Everything You Need to Know."

[45] Frank Kaplan, "Unenforceable 'Policy Interpretation' Provision," JDSupra.com (May 4, 2018).

language, or presumption or arbitrary interpretation or construction in favor of the insured or the company without reference to the reasonable expectation of either the insured or the company.

Thus, once again, a court would have to make the decision.

One argument related to the "adhesion" theory is whether such absolute language is "unconscionable." What makes a contract unconscionable?[46]

A contract may be found to be unconscionable based on five different factors.

- **Undue influence.** This is where one party exercises unreasonable pressure to get the other party to sign the contract (especially where one party takes advantage of the other in some way).

- **Duress.** This where one party uses threats to get the other to agree to the contract terms. This can take the form of physical threats or other types of threats (such as not releasing goods in the proper way until the other party signs).

- **Unequal bargaining power.** This occurs where one party has an unreasonable advantage over the other. This is usually proved if one party is aware that the other obviously did not understand the contract terms.

- **Unfair surprise.** When the party that creates the contract includes a term in the contract without the other party's knowledge that is not within the other party's expectations.

- **Limiting warranty.** A contract would be unconscionable if one party tries to limit their liability to a breach of contract or to any damages that they may incur on other party.

US Law Essentials writes that,[47] "[u]nlike contracts of adhesion, courts generally will not enforce unconscionable contracts. Courts will not enforce the contracts because they are considered too unfair. Unconscionability is a defense to contract formation. If one party is sued for breaching a contract, he might argue that the contract itself was unconscionable[;] therefore, the contract was not a legal contract and he cannot be forced to comply with its terms. To determine whether a contract is unconscionable, the courts will usually require that the contract be both procedurally and substantively unconscionable."

Of course, "the courts" are something one hopes to avoid when one submits a claim to one's insurer. Interestingly enough, these arguments seem to be lacking in pro-insurer decisions regarding absolute exclusions. Should the four-corner rule supersede?

The Reasonable Expectation of the Insured To Be Covered

As described by US Legal,

> The reasonable expectation doctrine is a principle applied in insurance law which states whenever there is an ambiguity in an insurance policy, it is resolved in favor of the insured's reasonable expectations. Usually, an ambiguity arises when there are plausible, competing interpretations of a policy term. Ambiguity is an essential prerequisite to application of the reasonable expectation doctrine.
>
> The doctrine applies only when a term in a policy is ambiguous, and an insured may not use it to obtain coverage when the plain language of exclusion clearly places an injury beyond the policy's scope. The reasonable expectations doctrine is not a rule granting substantive rights to an insured when there is no doubt as to the meaning of policy language.

[46] "What Is an Unconscionable Contract?" LegalMatch.com.

[47] "What is the difference between a contract of adhesion and an unconscionable contract?" UsLawEssentials (August 12, 2018).

Another article[48] on the subject disagrees with the above conclusions.

> Insurers are well familiar with a policyholder argument against enforcing an insurance contract as written, based upon legal principles designed to protect "unsophisticated" consumer policyholders. Specifically, policyholders often look to apply the *contra proferentem* rule of contract interpretation or the Reasonable Expectations Doctrine. The *contra proferentem* rule provides that if there is an ambiguity in the language of an insurance contract, courts may strictly construe the language against the insurer instead of interpreting the language in an evenhanded fashion. The Reasonable Expectations Doctrine refers to the principle that an insurance policy should be interpreted in accordance with the terms the policyholder thought it was obtaining, even if that interpretation is contrary to the plain terms of the policy.

More to the point, even California has not yet resolved the question. In "Analyzing an Insured's 'Reasonable Expectation of Coverage,'"[49] counsel at Bullivant Houser explains,

> In short, the Ninth Circuit affirmed a summary judgment decision that held an insured general contractor's refusal to complete a home construction project, which allegedly led to water damage, does not constitute an "occurrence" under a commercial general liability policy.
>
> What captured my attention was the brief discussion of the insured's argument that the general contractor had "a reasonable expectation of coverage" because the insurance company knew what kind of work the contractor performed. The insured argued that the insurance company could infer the insured expected coverage for its work, and as a result the insurance company "created an impression of coverage by not informing [the insured] that its work was not covered."
>
> The Ninth Circuit's opinion summarily rejected the insured's "reasonable expectations" argument, but it is an approach to coverage that insurance companies will likely continue to confront. Generally, the test stated in cases is whether the objectively reasonable average policyholder would hold a given expectation regarding coverage. Some states within the Ninth Circuit apply the "reasonable expectations" doctrine in various forms for resolving unclear policy provisions. To determine whether policyholder expectations will be a large interpretative factor in a given case, the state law that applies to the coverage dispute should be analyzed.

The "expectation" of the insured is a tough sell to the courts when predicated on whether the language is ambiguous or not. Most decisions find the exclusions to be (patently or on their face) unambiguous. But what about latent (i.e., hidden) ambiguities? Can we expect insureds to know their claim could be denied not because of the insured's actions but due to the acts of others over whom they have no relationship nor control?

Fair Claim Practice Regulations Universally Prohibit the Misrepresentation of Coverage and Unfair Trade Practices

The National Association of Insurance Commissioners has long championed consumer protections with respect to insurance company operations. In the late 1980s, they drafted fair claim practice regulations that were adopted by most states in some form. Often, the states implemented the fair claim practice regulations exactly as written. The same is true of unfair trade practices of insurance companies.

Most states did implement and accept the purpose of the Unfair Claims Settlement Practices Act, as the purpose was to set forth standards for the investigation and disposition of claims

[48] Kate L. Hyde and Eduardo DeMarco, "Limitations on the use of the Reasonable Expectations Doctrine and the contra proferentem rule by sophisticated policyholders," Kennedys (January 14, 2019).

[49] "Analyzing an Insured's 'Reasonable Expectation of Coverage,'" Bullivant Houser (April 2016).

arising under policies or certificates of insurance. Unfair claim practices were in fact defined.

The first definition states,

> [K]nowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverage.

Definition five, or F, depending on the state, covers

> refusing to pay claims without conducting a reasonable investigation.

Section 4 of the unfair trade practices defined an unfair trade practice as being

> a misrepresentation of the benefits, advantages, conditions or terms of any policy.

Section B also defined an unfair trade practice as

> to give out false information and advertising by making, publishing, disseminating, circulating, or placing before the public any assertion or a representation or statement with respect to the business of insurance or with respect to any insurer in the conduct of its insurance business which is untrue, deceptive, or misleading.

One could argue, for example, that an absolute bodily injury exclusion in an employment practices liability insurance policy that effectively eliminates emotional distress damages from coverage could fit one or more of these definitions.

Given the potential impact of absolute exclusionary language, insurance company advertising and "product summary sheets" stating that their policy has "very broad coverage, with a broad definition of wrongful act, or professional services, together with the services they provide" could be in fact misrepresenting the coverage. This is enhanced by the fact that insurers may in fact provide a broad definition of "wrongful act," yet they are silent on advising that many of the losses that thereafter arise from a wrongful act are excluded. That would be especially true with respect to those hazard classes that seem to have the highest frequency of absolute exclusions not limited to the actions or activities of the insured. That would be miscellaneous professional liability and insurance agents and brokers errors and omissions.

An Example

Consider one insurance company that has an online platform distributing professional liability insurance to consultants. An endorsement to the policy adds 14 absolute exclusions that are not limited to the insured's professional services or to the insured. Thus, should a management consultant be involved in computer or network security and advise the client accordingly, they may not be covered should the client later allege that the insured failed to notice they were not safeguarding their own funds properly. There are 13 other such absolute exclusions that are not limited to the insured's actions.

It is doubtful that any management consultant would read this endorsement and understand that, even though they are not the one giving the advice nor providing the security, the lapse by their client or any other third party would negate coverage under the policy should they be sued. This could fit the definition of an unfair trade practice or a misrepresentation of coverage under the fair claim practice regulations. The same would be true of any insurance agents and brokers whose policies may have upwards of 30 or 40 such exclusions that are, again, not limited to the activities of the insured. Numerous insurance agent policies out there have significant and lengthy absolute exclusions that are not limited to the insured.

While some courts may claim that these are clear and unambiguous, many insureds would see them as latently ambiguous.

Absolute Exclusion Takeaways and Potential Solutions

There certainly are solutions and takeaways to be discussed.

- Political pressure can be placed on the insurance commissioners in every state to review this matter together with their approvals of admitted policy forms. The average examiner may be unaware of how these exclusions are being interpreted and enforced by the courts.

- Pressure can be applied to the National Association of Insurance Commissioners to revise their model laws and regulations to deal with this problem as well. This could help the consuming public have a policy that they can understand, rather than having to seek the advice of counsel to find out how broadly exclusions will likely be interpreted.

- Insurance agents and brokers should look for unrestricted absolute language in prior act definitions and endorsements, as well as pending and prior and continuity definitions and provisions. The definition of wrongful act should be limited to the actions of the insured, and exclusions should also be limited to the actions of the insured.

- If an underwriter states something like "We would never do that; that's not our intent," be sure to confirm that in writing and with the expectation that the company will provide full indemnification if the claims department does otherwise. Better yet, obtain an endorsement that clarifies the language.

Statistics on Absolute Exclusion Court Decisions

Statistically, and based solely on my research, are the following as respects current court decisions.

NUMBER OF CASES BY POLICY HAZARD			
D&O	14	Commercial umbrella	1
Insurance broker E&O	3	Educators professional	1
CGL	2	Fiduciary liability	1
Title agents	2	Insurance company E&O	1
A&E	1	Product design E&O	1
Accountants E&O	1	Public officials	1
Attorneys E&O	1	Tech liability	1
Claims TPA E&O	1		

A&E: architects and engineers; D&O: directors and officers; E&O: errors and omissions; TPA: third-party administrator.

NUMBER OF CASES BY EXCLUSION OR PROVISION			
Contract exclusion	5	Employment related	1
Pollution	5	ERISA	1
Prior acts/ litigation	3	Fee dispute	1
Professional service	3	Insolvency	1
Profit advantage	2	Invasion of privacy	1
Securities related	2	Lack of good faith	1
Social media fraud	2	Medical services	1
Application warranty	1	Premium finance	1
Assault and battery	1	Products	1
Bodily injury	1		

ERISA: Employee Retirement Income Security Act.

NUMBER OF CASES BY STATE			
Alabama	1	New York	2
California	4	Ohio	2
Connecticut	1	Oklahoma	1
Florida	7	Pennsylvania	1
Illinois	2	Texas	4
Massachusetts	1	Virginia	1
Minnesota	1	Washington	1
New Jersey	2	Wisconsin	1
New Mexico	1		

NUMBER OF CASES BY YEAR			
2005	1	2016	1
2009	2	2017	4
2013	3	2018	6
2014	4	2019	5
2015	3	2020	4

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Mr. Fisher was the CEO of Executive Liability Managers, an independent wholesale brokerage specializing in the placement of professional liability and directors and officers liability coverages. For the past 46 years, he has been involved in the adjustment, investigation, and resolution of professional liability claims. He now heads up Fisher Consulting Group, Inc., a consulting, risk management, and expert witness services company.

Mr. Fisher has lectured extensively on professional liability loss control and has written more than 75 articles in trade journals and periodicals. He testifies regularly as an expert witness in cases dealing with the duties and obligations of professional as well as coverage and claims-made issues.

Mr. Fisher is the senior technical adviser for *Professional Liability Insurance (PLI)*, published by International Risk Management Institute, Inc. *PLI* was required reading by candidates for the Registered Professional Liability Underwriter (RPLU) professional designation sponsored by the Professional Liability Underwriting Society (PLUS).

Mr. Fisher served as a member of the PLUS Education Committee and the PLUS Board of Trustees. He has also served in other leadership positions in the organization, including the PLUS Southern California Steering Committee and the PLUS Peer Review Committee responsible for overseeing course material for the RPLU designation. He also served as secretary-treasurer and a member of the executive committee and was co-chair of the National Membership Committee. In 1998, Mr. Fisher served as president of PLUS. In 2019, he was the recipient of the PLUS Founders Award.

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