Current Trends: The Unintended Results of the Absolute Exclusion

Two mutually exclusive goals are beginning to result in apparently unintended results within the executive and professional liability markets. The quest for underwriting profits and the desire to develop clear (to whatever extent possible) coverage language have rapidly changed the coverage landscape within these two lines of coverage.

We recently received an employment practices liability (EPL) quote which did not include specimen forms and endorsements (not out of the ordinary). Once the necessary forms were received, a review of the policy forms found the customary bodily injury (BI) and property damage (PD) exclusionary language along with the usual and customary "carve back' for emotional distress (giving back coverage for "emotional distress" arising from "wrongful employment acts"). Such "carve back" is expected and necessary given that greatest amount of damages awarded in EPL claims are for the emotional distress arising from employment-related wrongful acts. But our curiosity was aroused by the inclusion of new exclusion, the "Absolute BI/PD Exclusion," eliminating the "carve back."

The addition of such exclusionary wording might lead some to opine that coverage for "emotional distress" is made "illusory" (an illusion, not real) and that an ambiguity now exists in the definition of a "workplace tort." Since the definition of workplace tort includes, in part, "wrongful infliction of emotional distress, mental anguish or humiliation …," this opinion appears to be correct. Unfortunately, recent court decisions have found such "absolute exclusions" to be "clear and unambiguous." The result is a finding of no coverage (leading to errors and omissions claims against the broker). Interestingly, such a finding would seem to confirm that coverage was indeed "illusory."

To complicate matters even further, the broker's E&O carrier may be able to escape if their policy includes an exclusion for any claim "arising …indirectly… from any claim involving wrongful employment practice acts." That too might trigger a claim against the broker providing the E&O policy and so the endless chain begins.

There is no real concern over this one event or within this purely academic exercise. The real threat is the current trend towards the use of "absolute exclusions," the consequences of which are real. Depending on the context, one's opinion, or whether it is the underwriting department or claims department making the decision, the resulting denial of otherwise covered claims may be unintended or intended despite the evolution of how the exclusionary endorsements came into being.

The Development of Absolute Exclusions

It would require the services of an archivist to determine when, how and why this trend towards the use of "absolute exclusions" got started. Such trends generally begin with court decisions and then morph beyond what was intended. Most likely the Montrose Chemical decision was the impetus behind the creation of such broad exclusionary wording. Montrose led to the development of the absolute pollution exclusion that became the norm in almost all commercial general liability (CGL) and other liability

Written by Frederick J Fisher, J.D. and edited by Christopher J. Boggs, CPCU, ARM, ALCM, LPCS, AAI, APA

policies. Once the use of "absolute exclusions" find traction in one area (and withstand court scrutiny), they generally find their way into other arenas.

Exclusionary language has evolved over the last 40 years. Many exclusions from the 1970's contained language that read, "Coverage does not apply to ….;" or "…to any claim for…;" or "…to any claim based upon…." Courts found that such language lacked specificity. As a result, by the late 1970's into the 1980's, exclusionary language adopted the "arising out of…" mantra and exclusions began to read "…based upon or arising out of…." A degree of concern and uncertainty remained which gave rise to language that eventually evolved into "…based upon or arising out of or in consequence of…," with the hopes this would make the intent clear.

Variations of this exclusionary language included: "The insurer shall not be liable to make any payment for loss in connection with any claim made against the insureds for …." No doubt courts might have struggled with the "…in connection with…" language, giving rise to even more exploratory language.

What is clear at this point in insurance history is the fact that most historical exclusions used one of the following as their basis:

- "to any Claim for…"
- "to any Claim based upon or arising out of the…"
- "to any Claim based upon, arising from, or in consequence of…"

Environmental liability cases were no doubt a (if not the) driving force behind the search for clear and unambiguous exclusionary language that could withstand court scrutiny. These cases created the desire among insurers to have policies that would not expose them to loss unless the policy was, in fact, designed to cover those types of claims. As a result the breadth of the absolute exclusions expanded as exampled here:

"Directly or indirectly, based on, attributable to, arising out of, resulting from, or in any manner relating…" or

"…based upon, arising out of, or attributable to any wrongful acts where all or any part of such acts…"

Thus began the era of absolute exclusion language "enjoyed" today.

Professional liability carriers began using this type of language to exclude a myriad of claims the policies were not intended to cover, such as the insured's own employment practice claims, environmental and or pollution claims, etc. This use is not unexpected. What is or should be unexpected is that forms applying such "absolute exclusion" wording may be giving rise to unintended results. Worse yet is the possibility that claims departments may now be deciding to take the position that these new results are in fact intended. If so, such conscious decisions may give rise to significant differences among insurers in today's marketplace.

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Series to Follow
This is the first part of a three-part series exploring exclusionary wording in insurance policies. The remaining installments explore examples of the impact of exclusions on claims and the dangers to agents. The series ends with solutions to policy exclusions.

The Resultant Impact of Absolute Exlusionary Wording on Claims - Part 2 of Series

An example of a claim against an environmental engineering firm in Florida demonstrates how absolute exclusionary wording should be considered. The firm was hired "to conduct a 'Phase I Site Assessment' of real property" the client was considering purchasing. The insured firm completed its assessment and reported that no "recognized environmental conditions" had been found. The client purchased the property based partly on that finding. After the client began developing the site, it found "a significant amount of construction debris" on the site. Several 55-gallon drums and half of an underground storage tank were discovered.

The new property owner filed suit against the engineering firm for breach of contract, negligent misrepresentation and negligence in failing to properly complete the Phase I Site Assessment. The firm tendered the claim to their professional liability carrier. The carrier began defending the insured under a reservation of rights; at the same time, the carrier filed suit in federal court seeking a declaratory judgment that it was not required to provide coverage due to the "pollution exclusion" in the policy.

Included on the policy was an "absolute pollution exclusion" that removed coverage for ***"[a]ll liability and expense arising out of or related to any form of pollution,*** *whether intentional or otherwise*." The district court determined that the claim fell outside of the pollution exclusion because it arose out of the failure to carry out professional responsibilities, not out of pollution. The court also held that it would be "unconscionable at best" to interpret the policy as excluding from coverage claims relating to "any form of pollution, regardless of causation." Because the engineering firm had not caused the pollution, the district court found that the exclusion should not apply.

Unfortunately, the court of appeals didn't agree and reversed the trial court's decision. The Florida Supreme Court agreed with the appellate court holding that the phrase "arising out of…" is not ambiguous and should be interpreted broadly declaring that the term "arising out of" is broader in meaning than the term "caused by" and is interpreted to mean "originating from," "having its origin in," "growing out of," "flowing from," "incident to" or "having a connection with."

Yet, a New Jersey case produced a different result. There, tenants of a rental property alleged that they were exposed to lead paint and sued the landlord for damages to compensate them for their supposed injuries. The insurance policy procured by the landlord's broker contained a "total pollution exclusion." As a result, the insurer denied coverage for the lead paint action. In response, the landlord filed an action against the broker asserting that he had specifically directed the broker to obtain insurance coverage for lead paint exposure (which the broker allegedly failed to do).

The broker, in due course, forwarded the landlord's action to its professional liability insurer. Surprisingly, the professional liability insurer informed the broker that there was no coverage for the claim under the policy in question. Citing the "absolute pollution exclusion" contained in the professional liability policy, the professional liability insurer refused to defend or indemnify the broker. The insurer stated that because the allegations of negligence advanced against the broker flowed from the underlying litigation concerning alleged lead paint poisoning, the absolute pollution

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exclusion precluded coverage for the landlord's third-party action against the broker. After presenting the arguments in court, the trial court ordered the professional liability insurer to defend and indemnify the broker as well as reimburse the broker's attorneys' fees.

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 New Jersey court got it right; the real question was whether there was an issue involving professional negligence, not a dispute involving pollution that may involve the application of the pollution exclusion. 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. The court found that the origin of the pollution was irrelevant as to the broker's coverage. Instead the court focused on the claim in controversy, which involved professional negligence, 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. (Original New Jersey case summary by Andrew S. Boris, *partner in the Chicago office of Tressler, LLP,* December 14, 2005).

Series to Follow

This is the second part of a three-part series exploring exclusionary wording in insurance policies. The remaining installment explores the dangers of exclusions to agents and solutions to policy exclusions.

The Big Danger of Absolute Exclusions for Agents and Solutions for Writing Policies- Part 3 of Series

While the two appellate court cases reviewed earlier relate to environmental claims, would not workplace torts, workers' compensation and other types of claims normally covered by other policies the insured might have also give rise to similar issues - especially in Florida? Consider the bodily injury and property damage exclusion. Since most insurance broker's, accountant's and lawyer's professional liability policies often use "absolute" exclusion language, would not all underlying claims also be excluded from coverage? If the determining factor, as in Florida, is the clear and unambiguous nature of the exclusion, then the concept of latent ambiguity is no longer a factor. Ambiguities in an insurance contract would have to be patently ambiguous to be ruled in the insured's favor.

Interestingly enough, though, one insurer now proudly claims on its website that it uses "for" wording in the bodily injury and property damage exclusions. Yet when asked if that means they now cover bodily injury and property damage arising from professional services, they had to add a "Contingent Bodily Injury and Property Damage Endorsement" to make it clear that they were covered!

Quite obviously, any professional liability policy will have to be carefully reviewed for such broad exclusionary language and its potential intent. This begs the obvious question, have the underwriters and claims personnel failed to communicate? But real dangers exist for many professionals, such as attorneys, who may handle environmental, workplace tort, workers' compensation or perhaps BI/PD claims. Insurance brokers will be similarly exposed because their policies, too, may contain "indirectly attributable to…" language.

The Solution

Legitimate reasons exist for the professional services, environmental/pollution events, workplace torts, workers' compensation, ERISA exclusions in the CGL. Usually these reasons were framed in the coverage intent and premium basis rather than being forced by court decisions. Plus, other policies exist that were specifically created to cover those events or as a result of exclusions in the liability form. Likewise, professional policies intended to cover the resultant damage from professional malfeasance, not to cover claims insurable under other policies. Yet, were professional liability policies really intended to exclude from coverage underlying claims of those excluded items? Weren't professional liability policies created to cover malfeasance of services irrespective of the underlying type of claim giving rise to the charge of malfeasance?

The solution to this vexing problem is twofold. First, ask the question of underwriting intent. The second is to get modifying carve-back endorsements such as the following in an insurance broker E&O form:

"However, this exclusion shall not apply to any **Claim** brought against any **Insured** for any actual or alleged failure of an **Insured** to place, effect, maintain or renew any insurance or bond, in whole or in part, on any particular terms or with any particular limit or limits, or to comply with the terms of any insurance or bond or to service any account of a customer or client of the **Named Insured …..**"

Another version would be **"…**however, this exclusion does not apply to the soliciting, placing, selling or servicing of insurance for a **Client** of the **Insured**…" with similar wording for attorneys, claims adjusters, etc.

Similar carve-backs would be necessary at a minimum for those exclusions involving

- Bodily Injury and Property Damage
- Personal Injury
- Workplace Tortes
- Discrimination
- ERISA
- SEC Exclusions
- Environmental Exclusions
- Intellectual Property or Privacy Exclusions

Every professional and executive liability policy should be reviewed to confirm that coverage for professional negligence or wrongful acts is provided and that damages stemming from the underlying nature of the loss are not

excluded. Beware, however, that being "conspicuous in its absence" may send the wrong message and explain why today's claim departments may deny a claim. If a policy needs several "carve backs" but only has three, doesn't that then mean the others were, in fact, intended to be exclusions?

About the Author

Frederick J. Fisher, J.D. is the President of Fisher Consulting Group, Inc. and was the Founder of **E.L.M. Insurance Brokers,** a Wholesale & MGA facility specializing in Professional Liability and Specialty Line risks. He is a Member of the Editorial Board for *Agents of America*; a Faculty Member of the Claims College, and Member of the Executive Council, School of Professional Lines sponsored by the Claims & Litigation Management Association and a course designer and webinar Instructor for the Academy of Insurance (sponsored by the *Insurance Journal*).

Since his career began, Mr. Fisher focused on one vision: providing financial security to the client. The result was a successful 40 year career in Specialty Lines Insurance. In 1975, Mr. Fisher began his career on the service side, as an Independent E&O claims adjuster. In 1982, he bought the Company, continued with claims, while expanding the firm's services to include qualitative claim auditing, risk management & loss control services, and acting as a TPA. His claim auditing techniques and recommendations resulted in substantial client savings (including the SCRTD now known as the Los Angles MTA). Many Insurers and self-insured's adopted not only the performance standards raised in the audits, but adopted his recommended Attorney Management Guidelines as a base, which are still in use today by many major insurers.

In 1995, he formed what is now known as ELM insurance Brokers, a firm that has acted as an MGA and Wholesale Broker of Professional Liability Insurance and Specialty Lines. He has lectured extensively on professional liability issues since 1978, and authored over 64 articles in trade journals and periodicals. He is the author of ***BROKER BEWARE, Selling Real Estate within the Law***. He designed a program to conduct on site pre-underwriting risk management assessments of a clients' professional liability exposures. In 1989, he became a Founding Member of the **Professional Liability Underwriting Society** (**PLUS**), and was elected to the **PLUS Board of Trustees** in 1993. After serving in all Officer capacities, he was elected ***President in 1997.*** He remains a Special Materials Expert for several **RPLU** courses and is the Senior Technical Advisor for ***The Professional Liability Manual,*** first published by the International Risk Management Institute in 1990. He has taught over 100 CE classes and lectures. He testifies regularly as an expert witness in cases dealing with the duties and obligations of professionals as well as on coverage and claims-made issues.

Fisher can be reached at 310-413-6200 , email: fjfisher@fishercg.com