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How to Prevent Your Insurance Company's Unilateral Expansion of Exclusions

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Insurance coverage disputes can resemble a cat-and-mouse game, where the insurance company makes every attempt to avoid paying a claim.

In some cases, an insurance company will attempt to expand the meaning of an exclusion to such an extent that it effectively leaves the policyholder *without coverage*. In the wake of Hurricane Katrina, many insurance companies are attempting to avoid coverage by giving unfounded and expansive readings to the concurrent causation exclusion which allegedly voids coverage if a covered peril, combined with an uncovered peril, simultaneously damages the insured property. In the case of Hurricane Katrina, insurance companies denied coverage for wind damage because it was combined with uncovered water damage. Adam F. Scales, a professor of insurance law, has noted that "[t]here's no question that the anti-concurrent clause is bad for policyholders" and that "it's not fair because it defeats policyholders' reasonable expectations." (Joseph B. Treaster, *Small Clause Big Problem: A Detail In Insurance Policies Is An Issue In Hurricane Claims*, The New York Times, August 4, 2006, at Sec. C.)

> *"[A]ny different construction would reduce the policy and its coverage to contradiction and absurdity."*

Illusory Insurance

Within the last couple of months, the Federal District Court for the Southern District of Mississippi rejected the application of the concurrent causation exclusion to damages stemming from Hurricane Katrina and found that "[t]his reading of the policy would mean that an insured whose dwelling lost its roof in high winds and at the same time suffered an incursion of even an inch of water could recover nothing under his [insurance] policy. . . . I do not believe this is a reasonable interpretation of the policy." (*Leonard v. Nationwide Mutual Ins. Co.*, No. CIV. A 1:05CV475 LTS, 2006 WL 2353961 at *7 [S.D. Miss. 2006].) Accordingly, the court held that such a reading of the exclusion would render the insurance illusory, and thus disallowed the insurance company's use of the exclusion to preclude coverage for wind damage. (*Id.* at *8.)

This practice is nothing new; as far back as 1930 Justice Cardozo encountered it in *Silverstein v. Metropolitan Life Insurance Company*, 171 N.E. 914, 254 N.Y. 81 (N.Y. 1930) and ruled against the insurance company on a causation defense and stated "[a]ny different construction would reduce the policy and its coverage to contradiction and absurdity." (*Id.* at 915.)

In another case, a bank was sued because it was involved in the sale of stock that was allegedly at a price that was under market value. In denying coverage, the insurance company invoked an obscure "future value exclusion" which precluded

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coverage for losses "arising out of any insured's failure to properly assess the projected *future* value of any real or personal property. . ." (emphasis added.) Plainly, this exclusion was inapplicable because the bank was sued for valuing the current stock price of the company in question at too low a point; not for projecting any future value. If such a construction of the exclusion were permissible, then the policy would yield no coverage for risks clearly contemplated—for example, any negligence arising from a bank's valuation of loan collateral would not be covered.

Another related tactic is to avoid coverage by giving an overly literal reading to the insurance policy, even if it contradicts the insurance company's past positions. In one matter, a bank was erroneously named as a defendant in a lawsuit over an alleged "Ponzi" scheme instead of the bank's predecessor-in-interest. The insurance company initially denied coverage by arguing that the policy excluded coverage because the successor bank was not the named policyholder on the predecessor's policy. The bank was not the named policyholder because the insurance policy was issued to the predecessor and was subsequently transferred to the successor bank. Despite the fact that the insurance policy indisputably covered the lawsuit and despite the fact that the insurance company had covered similar claims in the past, the insurance company denied the claim, forcing the bank to engage in laborious undertakings to secure a reversal of the insurance company's position.

Insurance companies are well aware of the law but can be slow to accept it and slower yet to pay coverage claims. However, once the insurance company is confronted and has their position dissected, the insurance company will often quickly offer a favorable settlement.

Conclusion

It is a governing principle of insurance law that an insurance policy will not be constructed in such a way to render the coverage purchased by the policyholder illusory. (*Butler v. Earl*, No.87-306-II, 1988 WL 15686 [Tenn. Ct. App. 1988].) It is paramount that an insurance policy and any exclusions contained therein are construed based on common sense and the reasonable expectations of the policyholder. (*Herald Square Loft Corp. v. Merrimack Mutual Fire Ins. Co.*, 344 F. Supp.2d 915 [S.D.N.Y. 2004].)

If an insurance company is stalling on your coverage claim with nonsensical constructions of exclusions as its justification—the law is on your side.