

Closing Quote



Monsters Under the Bed: Insurance Coverage Gaps and Other Invisible Exclusions



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Neither insurance policyholders nor courts look kindly upon exclusions from the broad coverage provided by insurance policies. Policyholders often balk at exclusions when preparing to pay their hard-earned dollars to buy insurance policies, and courts apply favorable rules of insurance policy interpretation to prevent the improper overuse of exclusions from the coverage provided by insurance policies.

Perhaps these two dynamics partly explain the growth in “invisible exclusions.” Because a policy with clear exclusions will not sell to the public, and because courts will not enforce exclusions that are not clear, invisible trapdoors are placed into the policy to allow an insurer to avoid a claim payment.

There are many improper attempts by insurance companies to avoid paying covered claims. Recent tactics include improper assertion of coverage gaps, assertions that underlying policy limits are not exhausted, and allocation.

The Dreaded Coverage Gap

No insurance policyholder would intentionally accept a “coverage gap.” Yet insurance companies regularly argue that coverage gaps are created by the change of an incumbent primary insurance company, change in definitions in insurance policies, or supposed “gaps” in purportedly seamless coverage between specialty insurance policies.

When a covered loss happens after the policyholder has changed its incumbent insurance company, both the incumbent and replacement often argue that the loss event is

the other insurer’s loss. When definitions in insurance policies of terms such as “loss” or “claim” are changed, mischief often ensues, as creative claims departments exploit “gaps” in the definitions in an attempt to avoid paying rightfully covered claims.

Finally, the proliferation of specialty policies such as fiduciary liability, cyber risk, intellectual property and many others gives rise to potential arguments by insurers that an event is outside the scope of their particular specialty policy and falls in a “gap.”

The Ridiculous Exhaustion Charade

Another coverage defense is the “exhaustion” argument. Policyholders seeking sufficient levels of protection often buy insurance programs structured in multiple layers. For example, each layer might provide \$5 million or \$10 million or more protection. Policyholders expect each excess layer to respond when the appropriate level of potential liability is reached.

Today, however, the following sequence plays out too often:

- 1) The policyholder files a significant claim;
- 2) A primary level insurance company asserts potential defenses to insurance coverage;
- 3) The policyholder, seeking to resolve the matter quickly, compromises by, say, accepting \$4.9 million of a \$5 million limit absorbing the difference; and
- 4) The next layer excess insurance company unreasonably and improperly argues that its supplier of insurance is not triggered because the prior layer of coverage was not fully “exhausted.”

A number of courts have accepted insurers’ unreasonable and frankly outrageous arguments along these lines. This line of argument has improperly eliminated scores of millions of dollars of paid-for insurance coverage.

The Unfounded Allocation Dodge

When no exclusion is available to avoid coverage, and no other valid argument exists to minimize claim exposure, insurers have often turned to the “allocation” argument.

Although full coverage is available under a single policy, the possibility that another insurance policy might apply provokes the self-interested argument that the insurer is only responsible for its “allocated share” of the covered loss. Bizarrely, buyers who purchase extra insurance may be subject to this often baseless argument with higher frequency than those who purchase less.

Gaps, exhaustion and allocation; to anyone but an insurance wonk, these dogs don’t bark. Yet they may bite. The fundamental promise of insurance — to provide peace of mind and seamless protection — is eroded when invisible attempts to avoid coverage are given credence. Insurance recovery attorneys fight these fights every day and hope to continue to restore the insurance promise to what policyholders are entitled to expect. ■

**Gaps, exhaustion
and allocation may
lead to denied
claims.**

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