

# Policy Wording Matters®



Written for Underwriters, Program Managers, Claims and Legal Professionals—and Policy Drafters.

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*This publication series was created by underwriters, attorneys, claim handlers and policy drafters within Gen Re in recognition of the link between good policy wording and good underwriting results. For more information, contact Mindy Pollack at 203 328 6153 or mpollac@genre.com.*

## The ISO Homeowners 2011 Revision

by Doug Clark, Gen Re, Stamford

The 2011 ISO revision of Homeowners coverage resulted in a Forms Filing Circular that was 475 pages long. It took that many pages to explain 14 policy changes, 11 new endorsements (including the six that are just for transition), 55 revised forms and six withdrawn forms. While some changes are worthy of note, this is not a game changer for most involved parties. As usual, the changes even include some that could easily be missed. As ISO put it:

*“We have also made formatting and editorial changes to the policy forms and some endorsements. Examples of these changes include adding and deleting commas and revising text for purposes of readability scoring.”*

The trick is identifying those revisions that may be of significance to your book or coverage positions. In this article, we delve into a few wordings that have been the subject of claims and court decisions. In some cases, a change may seem like housekeeping until you hear about the many challenges to its meaning.

Roughly 10 years have passed since the last Homeowners overhaul. In contrast, ISO generates a new CGL every three to four years. That means ISO had accumulated many fixes, and that it will likely be some time before they revisit the basic policy. Game changer or not, it merits a close look.

# The ISO Homeowners 2011 Revision

(continued)

## Common Changes—Property and Liability

Before we dig into the Property and Liability changes, here are two that affect both.

- > **Definition of Insured:** The structure of the language, here a definition, can make material easy for all to understand, or it could be just not clear enough and spawn litigation. The existing language referred to “. . . any person named above. . . .” This had litigation problems. Did it only mean those whose actual *names* were shown in the policy (Named Insureds) or did it mean those classes of persons shown immediately above (resident relatives) in the policy text? This intent was made clearer by placing the term “resident relatives” in the provision.
- > **Motor Vehicle Exclusion:** Coverage for Property and for Liability does not generally apply to “motor vehicles.” However, both apply to a non-registered vehicle “Used solely to service an ‘insured’s’ residence.” As even a riding lawn mower might occasionally be used on a neighbor’s land, coverage has been expanded by amending this to read, “Used solely to service *a* residence.”

## Property Changes

The Property revisions span perils, covered property and exclusions, and we think that the collapse provisions will get the most insurer attention.

- > **Deductible:** While not a major change for most coverages, the Deductible change takes the most ink to implement. This revises all six Homeowners Forms as well as 31 endorsements. Among others, the basic changes include:
  - Making explicit that the deductible applies “per loss.”
  - Adding language that states when multiple deductibles apply to a loss, only the higher deductible will apply.
  - Amending the deductible from being “Subject to the policy limits that apply . . .” to being “Subject to the applicable limit of liability . . .”
- > **Personal Property Located in Self-Storage Facilities:** The coverage for personal property in an HO policy is broad: “We cover personal Property owned or used by an ‘insured’ while it is anywhere in the world.” While the present HO forms include a sublimit of 10% of the limit of liability for Coverage C Personal Property for property off premises, this restriction only applies to items at an insured’s *residence* other than the “residence premises.” That clearly does not apply to property at one of the increasingly common self-storage facilities. There is also additional concern that losses at such a facility may go undiscovered for extended periods, increasing the severity of loss. To address this issue:
  - A new sublimit is introduced for these exposures—10% of the Coverage C limit.
  - An endorsement is available for purchasing greater amounts of such coverage, HO 06 14.
  - For the HO 00 08, the limited theft coverage is extended to include theft from a self-storage facility.
- > **Electronic Equipment:** The coverage for electronic equipment and related items off premises (Item 3 Special Limits of Liability under Coverage C—Personal Property) has been completely revised to address possible gaps between HO and Auto coverages for items used or stored in vehicles. To align the forms, ISO made these HO changes:
  - The limit for business property away from the “residence premises” (Item i) has been increased from \$500 to \$1,500 and, as before, does not apply to (1) antennas and media [tapes, wires, records, disks or other media] (2) used with electronic equipment that reproduces, receives or transmits audio, visual or data signals, and (3) that is in or upon a “motor vehicle.”



- The \$1,500 limit for portable electronic equipment (Item j) applies to electronic equipment that (1) reproduces, receives or transmits audio, visual or data signals, (2) is designed to be operated by more than one power source, one of which is a “motor vehicle” electrical system, and (3) that is in or upon a “motor vehicle.”
  - New \$250 sublimit for antennas and media used with the equipment identified above.
  - Corresponding revisions to “Property Not Covered” for the items now covered above.
  - Endorsement HO 04 12—Increased Limits on Business Property: Since the basic limit was increased from \$500 to \$1,500, the new limit for this endorsement is now increased from the current 20% to the revised 60% of the Total Limit of Liability shown in the Schedule.
- > **Collapse Coverage/Perils Insured Against:** Insurers are aware of considerable litigation surrounding the meaning of “collapse” under HO and CP forms, but a Pennsylvania Supreme Court decision hinged on other words around that term. The court focused on Additional Coverage for “. . .the risk of direct physical loss involving a collapse” and how that language applied to a dangerous structural condition. To require an actual collapse would be to ignore the words “risk of” and “involving,” which conveyed that an imminent state of collapse was also covered. The court held that the language could be read to include potential as well as actual collapse, and was therefore ambiguous.

**Gen Re Note:** In the *401 Fourth Street* case, a parapet wall was bowed and leaning inward. The insured’s engineer concluded that the internal bonds tying the wall to the frame had given way, and that the situation was extreme. There was enough evidence for the court to find that collapse was imminent. The court cited cases from California and South Carolina as well as the Ninth Circuit, where “risk of” language was also central to a finding that imminent collapse was covered. The new ISO revisions directly respond to these rulings by reinforcing that only actual and not potential collapse is covered. See *401 Fourth Street v. Investors Ins.*, 2005 Pa. LEXIS 1485.

The ISO HO policy contained “risk of” language in the Perils Insured Against provision, and thus could be subject to a similar interpretation. To limit coverage to that which applied before this decision, ISO:

- Amended the Provision for Perils Insured Against to lengthen and strengthen the language used to eliminate collapse. In particular, the “risk of” language is removed and it now insures “against direct loss to property.” Also, the coverage elimination now specifically encompasses loss of structural integrity and bulging/sagging, etc., as well as an abrupt falling down.

- Revised and lengthened the description of Additional Coverage 8. Collapse so that coverage given back only applies to “abrupt collapse,” as defined, and does not include a building in danger of falling down or caving in, or that is already separating or showing evidence of bulging/sagging, etc.
  - Amended the hidden decay and hidden insect or vermin damage portions of Additional Coverage 8. Collapse to apply to damage/decay to “. . . a building or any part of a building. . .”
- > **Vermin Preclusion:** This amendment to Perils Insured Against is intended to be clearer as to what is not covered. Often courts look to the dictionary definition of “vermin,” or do not consider all the damage done by animals. To address these cases, the provision is amended to remove “vermin” and exclude “Nesting or infestation, or discharge or release of waste products or secretions by any animals. . .”

**Bat Guano Decision:** Yes, there is even a case from Wisconsin involving bat excrement. A lower court concluded that the vermin exclusion did not apply, and the case was appealed on the pollution exclusion only (which the insured won). If you care to read more about it, see *Hirschhorn v. Auto-Owners Ins.*, 2010 Wisc. App. LEXIS 842.

- > **Theft Peril:** The Theft Peril currently applies for the personal property of a student at his/her school residence, provided the student has been at that residence at any time during the 60 days immediately before the loss. To accommodate the typical length of summer break periods, this has been extended to 90 days immediately before the loss.
- > **Earth Movement Exclusion:** The Earth Movement Exclusion has been revised for consistency with the revised Water Damage Exclusion introduced with endorsements HO 16 09 and HO 16 10. The existing Earth Movement Exclusion already contained references to “human or animal forces.” The new language refers to damage caused by “an act of nature or is otherwise caused.”
- > **Water Exclusion:** This change incorporates the revised water damage exclusion endorsements HO 16 09 and HO 16 10, which are therefore withdrawn. It also updates language in the HO 00 05 that was inadvertently left out of the “fix endorsement” HO 16 10.

**Gen Re Note:** The Water Exclusion endorsements reflected the lessons learned from Katrina and other major catastrophes, and are now part of the base policy. Harmonizing the Earth Movement and Water Exclusions reinforces intent while reducing arguments of ambiguity.



## Liability Changes

- > **Toy Vehicles Provision:** Currently, electric toy vehicles designed for use by small children can only be covered for off-premises use by attaching endorsement HO 24 13—Incidental Low Power Recreational Motor Vehicle Liability Coverage. Agents had expressed concern with the narrow scope, given the increasing use of toy vehicles. Also, the AAIS had expanded coverage to address these concerns. The ISO amendment will allow the unendorsed Homeowners liability coverage to apply to such toys on- and off-premises if they (1) are designed for the use of children under seven years of age, (2) are powered by battery(ies), and (3) are not built or modified to exceed 5 mph on level ground.
- > **Expected or Intended Injury Exclusion:** The current exclusion has an exception for self-defense by not applying to “. . . ‘bodily injury’ resulting from the use of reasonable force by an ‘insured’ to protect persons or property.” Coverage is being expanded by amending this exception to also apply to property damage resulting from such reasonable force. It will then read “. . . ‘bodily injury’ or ‘property damage’ resulting from the use of reasonable force by an ‘insured’ to protect persons or property.”
- > **Controlled Substance Exclusion:** The Controlled Substance or “drug” exclusion does not apply to “. . . the legitimate use of prescription drugs by a person following the orders of a licensed physician.” Today, many drugs can be legally prescribed by dentists, nurse practitioners and others who are not physicians. As a result, this exception will be amended so that the exclusion does not apply to “. . . the legitimate use of prescription drugs by a person following the orders of a licensed healthcare professional.”

## Other Policy Provisions

- > **Unit-Owners Modified Other Insurance and Service Agreement Condition:** The HO 00 06 policy (the Unit-owners Form) states that coverage is excess over the amount recovered from other insurance or a service agreement covering the same property. The filing for that form explained, in part, that “If the association does not recover because of a high deductible or other reasons, the unit owner does not recover.” Endorsement HO 17 34 was available to amend this so that the unit-owners coverage “. . . will pay only for the amount of the loss in excess of the amount due from that other insurance or service agreement, whether they can collect it or not.”

Additional language is being inserted in response to requests for greater clarity with respect to the deductibles under any such other insurance or service agreement. This additional language makes the HO 00 06 unit-owners

coverage “Primary with respect to any amount of the loss covered by this policy and not due under such other insurance or service agreement because of the application of a deductible.”

- > **Loss Settlement Condition:** Due to regulatory comments and questions, under the HO 00 02, HO 00 03 and HO 00 05 policies the paragraph relating to ACV settlement and subsequent claim for the additional amounts to equal replacement cost has been amended to require notification “within 180 days after the date of loss.” Previous language referred to the insured’s intent to repair within 180 days of the loss. For HO 00 08, which does not provide for the option to endorse on Law or Ordinance coverage, the loss settlement language has been amended to eliminate a reference to added coverage for increased costs incurred to comply with the enforcement of any ordinance or law.

## New Endorsements

In addition to a series of transition Endorsements, ISO introduces revisions for several additional forms, including:

- > **Loss Assessment Coverage:** Endorsement HO 04 35, now re-titled as “*Supplemental Loss Assessment Coverage*,” is being broadened by eliminating the special sublimit of \$1,000 that applied to assessments as a result of a deductible in an insurance policy purchased by a corporation or association of property owners.
- > **Replacement Cost Loss Settlement for Certain Non-Building Structures on the Residence Premises:** The specific list of items that can be subject to this coverage upgrade to replacement cost is increased to include [in-ground and semi-inground] swimming pools, hot tubs and therapeutic baths.
- > **Limited Water Back-Up and Sump Discharge or Overflow:** Existing endorsement HO 04 95 is being revised as follows:
  - Coverage for damage from back-ups through sewers or drains applies only when the loss is caused by water or waterborne material which originates from within the dwelling where you reside. We see many claims that involve water originating outside the building; this revision should make the intent clearer.
  - The special deductible incorporated within the endorsement was eliminated and now the policy deductible will apply.
  - The pre-printed limit of \$5,000 was deleted. The fill-in for the limit can have the basic limit of \$5,000 or available increased limits of \$10,000, \$15,000, \$20,000 or \$25,000.
- > **Trusts:** Trusts currently call for the use of endorsement HO 05 43 under which the trust and trustees are the insureds. ISO has learned that for most trusts, the grantor

(or settlor) is the person requesting the policy and who formerly owned the property now being held in trust, and who continues to reside on the property and is designated as the trustee. Thus, in these instances, the policy could be issued in the name of the grantor (who would be the named insured under the policy) instead of in the name of the trust. The trust and the trustee would then have limited insured status.

- > **Canine Liability Exclusion:** New endorsement HO 24 77 will exclude injury or damage that arises out of direct physical contact with a canine named and described in the Schedule of the endorsement. Please note that under Rule 617 that applies to this endorsement, the exclusion only applies if the named insured also acknowledges the canine exclusion in writing. This happens to be identical to HO 24 84, which was adopted in New Hampshire in 2004.

### ISO Personal Umbrella Policy

The Personal Lines staff at ISO did not choose to revise the Personal Umbrella concurrently with their Homeowners policy. This differs from our recent experience with Commercial Lines, where the ISO Commercial Umbrella was revised concurrently with the General Liability policy. We have learned that ISO Personal Lines staff are aware of the timing gap and intent to update the Personal Umbrella in the next few months.

### Personal Injury

The explosion in type and use of social media has sparked a need for updates as well as caution with regard to exposure. A defamatory statement or invasive photo can travel around the world in seconds. To address these twin concerns, ISO offers two changes:

- > **Manner of Publication:** The existing endorsement, HO 24 82, is broadened to explicitly recognize new and emerging forms of communication. The portion of the definition of personal injury related to “publication” will include publication *in any manner* to more clearly indicate that coverage applies to electronic publication [such as e-mails and material on websites]. The limit in this endorsement continues to apply on a “per offense” basis.
- > **Aggregate Limit:** ISO acknowledges that insurers have increasing concerns for the extent of loss that can follow offenses over the Internet. In fact, they may be reluctant to provide Personal Injury coverage with the HO policy. To encourage more PI availability while protecting insurers from massive exposures, ISO introduced a second personal injury endorsement containing an aggregate limit, with HO 24 10. This limit would apply for any one policy period regardless of the number of insureds, offenses, claims made or suits brought.

**Gen Re Note:** AAIS approached the exposure issue from a different angle. In HO 4001 01 06, the AAIS endorsement applies a “per victim” limit, so that all personal injury to any one person or organization is capped. The limit applies to all personal injury to

that person regardless of the number of offenses. Both approaches get at the cumulation concern, but if more than one “victim” is involved, the AAIS endorsement puts additional limits at risk.

### Adopting the New HO

Whenever ISO files a new base form, insurers have to determine whether they will adopt the new version or stick with the older one. We can appreciate the time and expense of a filing. Your decision will depend, in part, on the importance of these many revisions to your book of business and coverage positions. The 2011 HO does have many benefits, and it could be another 10 or so years before the next one appears. Given the timeline, keeping up with ISO Homeowners editions is not really that taxing and probably worth the effort. ■

*Doug Clark is a Vice President and Policy Wording Specialist in Gen Re’s Treaty Underwriting Department. Doug provides policy form support to Gen Re clients in Casualty, Property and Professional Liability lines, and monitors Bureau form issues and changes. You can contact Doug at 203 328 6487 or dclark@genre.com.*

### Texas Reforms Auto Policies

### Big News

In a departure from standard practice, the Texas Department of Insurance Department has advised insurers that the new financial responsibility (FR) levels effective January 1, 2011 will apply to in-force as well as new and renewal policies. Per Bulletin B-0048-10, the limits of auto policies in effect on January 1 will automatically be increased to the new 30/60/25 levels, and insurers may not charge additional premium for the expanded coverage. The TDI notes that past FR increases have followed a “roll out” process for FR changes but that the 2008 legislation did not specify this approach or give the TDI the necessary authority. As a result, it appears that all in-force auto insurance policies with minimum limits are reformed to provide the higher 30/60/25 FR limits as of January 1—at least per the TDI interpretation of the law.

Courts and regulators often reform policy words, but not often are policy limits adjusted after the fact. We are not aware of any other states to have taken this approach, and we hope that Texas has not started a trend.

See our November 30 *E-News Auto* e-mail on Texas and New Mexico developments for more on this topic.

# AAIS Personal Umbrella Excludes Coverage for “Electronic Aggression”



by Joseph S. Harrington, CPCU, ARP, AAIS Director, Corporate Communications

AAIS is introducing a new provision excluding liability coverage for bodily injury, property damage, and personal injury arising out of an offense it calls “electronic aggression.”

The new exclusion is written into the base form of the newly revised AAIS Personal Umbrella Program being filed countrywide this fall. (AAIS is a national advisory organization that develops standardized policy forms and rating information used by more than 600 property/casualty insurers throughout the U.S.)

AAIS is introducing the exclusion in response to lawsuits for injuries arising from offenses involving the use of electronic media. Recent suicides by teens allegedly subjected to cyber-bullying provide dramatic examples of the magnitude of injury that can result.

The exclusion states that electronic aggression includes but is not limited to harassment or bullying committed by means of an electronic forum (blog, social networking site, chat room, etc.) or by other electronic means, such as e-mail, instant messaging, or text messaging.

The term “electronic aggression” is one used by the U.S. Centers for Disease Control to describe a new form of behavior linked to physical injury; AAIS deliberately chose a term used by an agency considered to be authoritative in matters of human health.

## *Not Fortuitous*

According to AAIS, there are at least three reasons why damage and injury arising from aggression carried out through electronic media are appropriately subject to an exclusion.

First, since harassment and bullying are conscious acts, losses that arise from them are not fortuitous. It is well-established that personal liability coverage extends to losses that are accidental in nature, and does not extend to intentional acts or injuries, even if the injury is more severe than intended.

Secondly, electronic aggression is a new exposure, the potential for which has grown very rapidly to affect many households, especially those with teenaged children. Given the newness of the exposure and its potentially pervasive impact, insurers do not have enough loss history to rate coverage for it.

Thirdly, settlement of claims is likely to be extremely complicated and reliant on court determinations that have yet to be made, and which may vary widely from case to case and jurisdiction to jurisdiction.

In many cases, it is not easy to distinguish between victims, aggressors, and bystanders when adolescents engage in a rapid-fire electronic exchange.

For example, what would be the liability of a teenager (and his or her parents) who does not initiate a hostile exchange or display any hostility himself or herself, but who joins an exchange and passes along hostile or demeaning messages?

## *Excluding Activity*

Given the likely complexity of cyber-bullying and related claims, and the impracticality of sorting them out to determine intentionality, AAIS believes it is best to make the activity itself—electronic aggression—subject to the exclusion, and not rely solely on existing intentional acts or intentional injury exclusions.

AAIS personal liability forms already include a standard exclusion for bodily injury or property damage intended by the insured, even if the injury is greater than what was intended. Similarly, AAIS personal injury coverage provisions include exclusions for acts that an insured knew was false or would result in personal injury.

An intentional acts exclusion should protect a carrier from a claim when an insured clearly acted with intent to cause damage or injury. But it is not definitively established that such an exclusion would apply if the insured intended to embarrass or humiliate another, but not cause physical harm.

### New Cyber-bullying Exclusion

The AAIS Personal Umbrella base form now contains this exclusion:

This Personal Umbrella Liability Coverage does not apply to: . . .

10. "bodily injury", "personal injury", or "property damage" that arises out of electronic aggression, including but not limited to harassment or bullying committed:

- a. by means of an electronic forum, including but not limited to a blog, an electronic bulletin board, an electronic chat room, a gripe site, a social networking site, a website, or a weblog; or
- b. by other electronic means, including but not limited to email, instant messaging, or text messaging.

AAIS personal injury coverage has also been updated in recent years to, in essence, maintain coverage for an insured's own remarks made using electronic media, but provide no coverage for remarks of others made on electronic forums that an insured owns or controls.

Even with that restriction on personal injury coverage, AAIS believes it is still in keeping with traditional personal liability coverage to exclude all coverage for damage or injury arising from circumstances where anyone is willfully using electronic media in a hostile, abusive manner that targets another individual or group. ■

*Joe Harrington is Director of Corporate Communications for the Association of American Insurance Companies in Wheaton, Illinois. You can contact Joe at 800 564 2247 ext. 217 or joe@AAISonline.com.*

### Social Media Dialogue

Are you monitoring social media issues? We have been tracking liability and coverage form developments for some time. Would you like to discuss the marketing and/or underwriting implications? Just contact your Gen Re account executive so we can explore the issues and options.

### Removing (Un)Necessary Language

Often companies revise their policies to remove language perceived as unnecessary or as potentially conflicting with other provisions. Sometimes the courts then tell us that the deleted language was more important than first thought.

The accident underlying a recent coverage case involved three trucks and one personal auto. After settlements and dismissals, claims remained against the driver and his employer, a trucking company, under various negligence theories. The same insurer had issued the trucking company a Business Auto and GL policy, each with \$1 million limits. The GL policy appended an endorsement with an Auto exclusion barring coverage of claims arising out of the "ownership, maintenance, use or entrustment to others" of any auto. The original Auto exclusion, which was replaced by the endorsement, contained additional language denying coverage of "negligence or other wrongdoing in the supervision, hiring, employing, training or monitoring of others" by that insured. The insurer argued that negligent hiring, etc. was an insignificant factor in the accident, and that the exclusion for entrustment encompassed the negligence claims.

The Mississippi Supreme Court disagreed and found coverage, noting that the insurer "chose to remove" the additional negligence language from its policy. However,

a trial court was asked to determine whether negligent hiring, etc. was a substantial factor in causing the accident. If such causation is found, the insurer would be responsible for paying the limits under the Business Auto and GL policies.

Why did the insurer remove the negligence language from its Auto exclusion?

There are no hints in the court's decision, so we can only guess. At the time of the accident, this negligence language was already a part of Auto exclusions in Bureau and most proprietary policies, so perhaps it was removed at the request of a significant agent and/or policyholder. Maybe the insurer thought that the additional words were no longer needed with entrustment excluded in the endorsement. In the end, the insurer made one too many edits, at least for this court. *Cherokee Ins. Co. v. Babin*, 2010 Miss. LEXIS 295.

### Cut and Paste



# Evaluating Sexual Abuse Exclusions—Personal and Commercial Challenges

by Mindy Pollack, Gen Re, Stamford

In recent publications, we have discussed the challenges of drafting sexual abuse exclusions that will hold up in the courts. Given the potential severity of these claims, it is not surprising that insurers put a lot of time and effort into clear policy wording. Sometimes coverage is found under less than ideal provisions, but we have also come across new cases finding coverage under standard-setting language. We review the latest rulings and what they mean for drafting successful exclusions.

## Personal—Homeowners and Umbrella

The most commonly used language is probably the ISO HO-3, which excludes bodily injury and property damage “arising out of sexual molestation, corporal punishment or physical or mental abuse . . .” The AAIS and MSO basic HO forms have almost identical language. In almost all sexual abuse claims, insurers also point to Intentional Act and/or Criminal Act exclusions. However, several recent cases discussed in past Policy Wording Matters make it clear that some courts will not apply Intentional Act wordings against innocent co-insureds. The state supreme courts in Ohio and California have held that Separation of Insureds provisions and/or public policy required coverage of innocent insureds sued only for negligent oversight and other unintentional conduct.

Can these same arguments apply to defeat the standard Sexual Molestation exclusion? Unlike Intentional Acts provisions, the Sexual Molestation exclusions do not hinge on who did the acts or the mindset of the actor. They apply to injury “arising out of” sexual misconduct. We can find cases where courts found coverage because some injuries were not inextricably tied to the sexual misconduct, but we consider a different and much simpler issue here. The fact pattern is a teenage child molests younger children and the teenager’s parents are sued for negligent supervision.

Two very recent decisions are on point and reach different results.

- > **Innocent Insureds—Kentucky:** A lower federal court held that a Sexual Molestation exclusion identical to ISO precluded coverage of the negligent supervision claims against the innocent parents. The court states that the sexual molestation exclusion “remove(s) from coverage an entire category of claims—those arising out of sexual molestation and intentional acts.” When read with the Severability clause, there is no coverage. Even if the policy applied separately to the innocent insured, the exclusion clearly applies because the wording makes no distinction based on who committed the acts. No public policy arguments were advanced or discussed. *ANPAC v. Encompass Ins. Co.*, 2010 U.S. Dist. LEXIS 87298.
- > **Innocent Insureds—Indiana:** A lower federal court refused to apply a Sexual Molestation exclusion, finding that the innocent insureds are entitled to coverage. The reasoning was based on the Severability clause in the policy. According to the court, a “reasonable insured would believe from the severability provision that their insurance coverage and any exclusion . . . would be judged on the basis of their particular conduct and acts within their control. To then exclude coverage on the basis of another insured’s conduct creates a conflict . . . and denies the reasonable insured the coverage protection which the severability provision affords.” The same thinking made the sexual molestation, criminal acts and intentional acts exclusions inapplicable to the negligence claim against the innocent insureds. *American Family Mut. Ins. Co. v. Bower*, 2010 U.S. Dist. LEXIS 118567.

The two above decisions showcase a pure legal issue—are the sexual molestation exclusions enforceable against the “innocent insureds” sued for negligence? The commercial forms already include the negligent supervision, etc. language in a variety of exclusions, such as Auto, Assault & Battery and Sexual/Physical Abuse. Some commercial carriers actually adopted stand-alone “negligent hiring, retention, supervision” clauses into their forms, rather than include that language in individual exclusions. One Personal Lines Bureau wording for reference comes from the AAIS, which revised its Intentional Acts provision for Ohio after the *Safeco v. White* ruling. (See our December 2009 *Policy Wording Matters*.)





### Case Watch: California on Intentional Acts

The California Supreme Court will soon decide whether an insurer can deny coverage to innocent insureds from the intentional acts of other insureds. The case involved arson by the insured's son. The policy excluded any loss arising out of any act "committed by . . . **any insured** having the intent to cause a loss" and fraud by "**any insured.**" (Emphasis added) The insureds argued that the fire insurance statutes denied coverage for intentional and fraudulent acts by "the insured" and did not penalize innocent co-insureds. The California Court of Appeals enforced the exclusions, but now the California Supreme Court will have the final word. Given the high court's earlier *Minkler* decision finding coverage for innocent insureds in a sexual abuse case, the signs are not encouraging. *Century National Ins. v. Garcia*, No. 10-24, S179252, (nonpublished opinion; in Los Angeles County Superior Court; BC379522.)

### Commercial—BOP/GL and Umbrella

Commercial carriers have already addressed the negligence arguments in policy wordings, which have been enforced for the most part. The litigation issues here deal with corresponding grants of coverage, usually through endorsements providing sublimited protection and unique terms. Commercial risks working with young children, be they camps, schools, churches or day care, are likely to seek some coverage for sexual misconduct and physical abuse. These endorsements help carriers respond to the need without exposing full limits. The question here is whether those sublimits will apply as insurers intend—or if insurers will end up paying multiple sublimits, the full policy limit, or, worse yet, the full policy limit plus the sublimit.

**1. Physical Abuse—Florida and Texas:** Early cases from Florida and Texas showed insurers how courts could parse actions and potentially identify non-sexual conduct that triggered the basic GL limit. To address that possibility, insurers responded with wordings that combined physical and sexual abuse, so that related acts were excluded and then covered under a sublimit. The Florida case also pointed up the fact that a court could find multiple occurrences/limits when the physical and sexual acts were separated by sufficient time and space. Insurers will always be vulnerable to such outcomes depending on the facts of the case, but by including related physical and mental injury with sexual abuse a major coverage loophole was closed. Personal lines policies also made this adjustment.

**2. Stacking—Florida:** A recent Florida case should help insurers focus attention on how their endorsement works when multiple parties are involved. Most forms aggregate sexual acts for a single perpetrator and relate them back to the policy period when the acts began. The language to accomplish this result is critical, and may not always work the way the insurer intends.

In a recent Florida case, a daycare center policy excluded sexual abuse, but an endorsement gave a \$50,000 "child sexual abuse injury incident limit" and a \$100,000 aggregate limit. The policy went on to state that "multiple incidents of abuse caused by one perpetrator . . . shall be deemed to be a single incident of abuse and shall be deemed to have taken place on the date of the first of such acts." Additional language stated that these limits were the most the company would pay for a single act or multiple acts "regardless of the number of insureds, claims made, suits brought or persons or organizations making claims." This "per perpetrator" language was tested when five victims had claims over three policy periods, all tied to a single person. The key question was this: Does the policy clearly apply one limit for all victims of the single perpetrator, or for each victim? The court found the language ambiguous when multiple victims were involved. Part of the problem was the absence of a definition for "incident of abuse," and the fact that no policy language addressed whether an incident can include more than one victim. The common claims-made policy provision applying one limit regardless of the number of persons making claims was not enough. Child victims are not "persons" bringing claims because they lack the capacity to do so. The only redeeming aspect of the decision is that the policy limit did not reset with each policy period. In the end, the insurer's total exposure was \$250,000, instead of the \$50,000 it intended. *Lantana Ins. Ltd. v. Ritchie*, 2010 U.S. Dist. LEXIS 98012.

Like their personal lines counterparts, most policy solutions for sexual misconduct have been enforced by the courts. We have not noticed any major rewriting of these endorsements in recent years, as insurers seem comfortable with their carefully crafted forms. Still, *Lantana* and other decisions remind us that satisfactory language still needs to be revisited from time to time.

**Sample Wordings:** Gen Re has sample GL and CU wordings available with abuse exclusions and sublimits, and several past research publications address the topic. If you would like to discuss, please contact your Gen Re account executive.



## Drafting Takeaways

When we study Sexual Molestation exclusions and sublimits, we have the learnings from more than these cases in mind. Decisions on liquor liability, auto and construction defect wordings can also be instructive. Here are a few lessons that stand out:

- ✓ **Physical, Emotional and Sexual Abuse**—address all acts and injuries that can be connected to the sexual abuse, to avoid an additional limit.
- ✓ **All Coverage Parts**—The exclusion should apply to the PI/PD and the AI/PI coverage parts, before coverage is restored for specified acts and damages. This should include personal injury offenses, such as false imprisonment and invasion of privacy, so they cannot trigger dual coverage under the base policy.
- ✓ **“Arising Out Of” language**—Most states will give this language a broad reading, so that all acts and injuries arising out of the “physical, emotional and sexual abuse” will be encompassed within the endorsement and sublimit.
- ✓ **Stacking Per Perpetrator**—If the insurer intends stacking on a “per perpetrator” basis, the Florida decision provides the lesson that wording be included to state that a single limit applies for each perpetrator regardless of the number of victims. Since families of abused individuals may also have rights of action, the stacking wording should not be limited to the direct victim. In contrast, many insurers opt for “per victim” language, and in such cases the wording should apply regardless of the number of perpetrators, if that is the intent.

- ✓ **Stacking Per Policy Period**—Strong, related acts language would relate back to when the conduct began, and tie in all acts and injuries to that first policy period. Construction defect litigation has illuminated some weaknesses in language when the damage from a single defect changes in location or context. For sexual molestation covers, even later emotional injuries should tie back to the occurrence and policy period when the misconduct began.
- ✓ **Negligence Allegations**—For personal and/or commercial business, inclusion of negligence language can help insurers avoid severability arguments like those accepted in Ohio, California and Indiana courts.

Even the clearest exclusions and endorsements can be defeated by “public policy” or “reasonable expectations” if a court finds them applicable. However, improved wordings can prevent cases like the one in Florida, and that is within the control of the insurer. ■

*Mindy Pollack is a Vice President and EPLI Business Development Specialist in Gen Re’s Treaty Department. She is also the editor of Gen Re Research publications, and draws from legal, claims and contract/policy experience to contribute many articles to a variety of newsletters. You can contact Mindy at 203 328 6153 or mpollac@genre.com.*

## Good Reading



*General Liability Coverage: Key Issues in Every State*, by Randy Maniloff and Jeffrey Stempel, Oxford University Press, January 2011 publication date. This extensive resource provides insurers with access to the coverage law of 50 states on a variety of important issues, including number of occurrences, faulty workmanship, pollution exclusions, innocent insureds and invasion of privacy. Randy, a partner at White and Williams, has contributed to several Gen Re publications on these and other coverage topics. For more information, go to: [www.us.oup.com](http://www.us.oup.com).

## Prior and Pending

In our June 2010 edition of *Policy Wording Matters*, we shared research on:

- > Latest Wordings in the Marketplace
- > Umbrella Dropdown Lessons from Losses
- > Bureau Form Updates
- > Pollution Exclusions



Policy wording issues were also discussed in other Gen Re Research publications, including:

- > *Casualty Matters* (November 2010)
- > *Insurance Issues*—The Chinese Drywall Problem (September 2010)

# A Summary of New Laws and Rulings Affecting Insurance Policies and Coverage



## *Arkansas and Connecticut Mandate SERFF Filings; California Proposes for Workers' Comp.*

The Arkansas Department of Insurance has issued a regulation requiring use of the SERFF system for filings of all policy forms, effective March 1, 2011. Bulletin 9-2010 exempts farm mutual insurance associations and surplus lines carriers. Connecticut, through Bulletin IC-26, mandates filings through SERFF by January 1, 2011. California, where SERFF is already the standard, has proposed its use by Workers' Compensation carriers.



## *Connecticut and Iowa Issue Guidance on Certificates of Insurance; Louisiana Tightens Law*

Connecticut and Iowa joined the long list of states issuing rules to clarify the use of certificates of insurance. Connecticut Bulletin S-14, effective November 9, 2010 states that certificates of insurance do not amend the policy, and only serve as evidence of insurance. Iowa Bulletin 10-04, issued July 13, 2010 is similar in content and also took effect immediately. Louisiana enacted H 447 to strengthen the form and filing requirements applicable to certificates of insurance.



## *Louisiana Exempts Surplus Lines From Form Filings*

A new Louisiana law, H 285, exempts approved unauthorized insurers from filing forms with the insurance department. The law took effect on June 9, 2010.



## *Wisconsin Issues Readability Rules for Personal Lines Policies*

The Wisconsin Office of Commissioner has filed a readability rule that would require personal lines carriers to post information on their websites about how insureds can obtain electronic or paper copies of their policies. Town mutuals are exempt from the provision. In addition, all P/C insurers must notify insureds that a full policy package will be provided within five business days of their request of an electronic copy and 10 days if a paper copy is preferred. The rule would not change the current Flesch score for P/C policies. Depending on when the rule is published, it would take effect on either January 1 or February 1, 2011.



## *Contaminated Food Sold in Two Places—Two Occurrences, One P-CO Aggregate Limit*

The scenario in this case is all too real for carriers serving the restaurant business. An *E.coli* outbreak affected 341 persons in one Oklahoma county. The insured's restaurant was identified as the source. Twenty of the 341 persons attended a church luncheon catered by the restaurant. Although the exact culprit was not isolated, cross contamination was likely as some items were served at both the catered lunch and the restaurant itself. GL and Commercial Umbrella policies were pulled into litigation, with the issues being the number of occurrences and amount of coverage:

- > General Liability—\$1 million per occurrence, \$2 million general aggregate and \$2 million products-completed operations aggregate. The policy contained a Products Hazard Endorsement (PHE) for Restaurant operations that revised the definition of P-CO, to the affect that P-CO includes all injury arising out of "your products" if the injury ". . . occurs after you have relinquished possession of those products." It also applied to injury arising out of your products "on, from, or in connection with the use of any premises described in the Schedule, or in connection with the conduct of any operation described in the Schedule, when conducted by you or on your behalf . . ."
- > Commercial Umbrella—\$2 million aggregate. No wording/coverage was in dispute.

## Legal Round-up *(continued from page 11)*

The court first determined that “temporal and special parameters” should guide the occurrence analysis, and concluded that there were two occurrences. They involved different people and places, despite some overlap. The court then turned to the PHE, and found that all of the restaurant’s operations were encompassed within the PHE, whether the food was served at the restaurant itself or at the church. The insureds contended that the church was not a premises described in the Schedule, but the court answered that the endorsement also applied “in connection with an operation described in the Schedule.” Finding that all the food claims arose from the conduct of operating a restaurant, the P-CO aggregate limit applied. Since the General Aggregate limit expressly excluded all P-CO claims, the insured’s coverage was limited to the \$2 million P-CO aggregate limit. Without the proper endorsement, the GL insured *might* have to pay two aggregate limits, or \$4 million. The CU policy provided the next \$2 million in coverage, and

there was no dispute over that obligation. *Republic Underwriters Ins. v. Moore*, 2010 U.S. Dist. LEXIS 115597.

**Point:** There is a lot more policy language referenced in the case, and we urge you to read it all if restaurant exposures are in your book. The bottom line is that the Endorsement—which was only just added to the policy—made the difference. The ISO restaurant endorsement represents the Bureau’s approach to the class of business and while not mandatory, the ISO manuals call for its use. It is not clear how the prior form would have applied to these facts, and the court had no reason to address it. Given the enormity of damages and the complexity of the insurance policies, we expect an appeal of the ruling.

Gen Re GL and CU underwriters pay a lot of attention to food contamination exposures. If they can help you evaluate issues and wording, let us know!

### Revisiting (Asbestos Exclusionary) Wordings

A recent New York appellate decision reminds insurers that even good policy wordings need to be reviewed and refreshed from time to time. What appears to be indestructible language today may be weakened by a court opinion tomorrow.

The asbestos exclusion in the NY case was one we have seen in many GL forms. It denied coverage for the “inhalation or prolonged physical exposure” to asbestos, the “use “of asbestos in construction, the “removal” of asbestos from structures and products, and the “manufacture, sale, transportation, storage or disposal” of asbestos or products containing asbestos. Sounds comprehensive, right? But how does that language apply to the dispersal of asbestos through a building during the course of emergency water damage service by the insured? The New York appellate division

did not see “release” or “dispersal” in the clause, so the exclusion did not apply. And yes, while the pollution exclusion did contain these terms and asbestos is an irritant, the court held that asbestos was not a named pollutant, and to apply the pollution exclusion would render the asbestos exclusion meaningless. *Great American Restoration Services v. Scottsdale Ins. Co.*, 2010 N.Y. Slip Op. 08067 (NY. App. Div., Nov. 9, 2010).

The takeaway from this case goes beyond asbestos. You can’t just put a good form to bed and take a rest. Insurers need to constantly monitor loss scenarios and legal developments, so they can be sure that the wording is still as good as they first thought.

### Closer Look



### Coming Soon

- > EPLI Monitor
- > Valued Policy Law Survey
- > UM/UIM Survey Update



*The difference is...the quality of the promise..*

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