

# The Illusory Coverage Doctrine: Going Beyond the “Plain Language” of the Policy

2021 Annual Meeting  
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# The Illusory Coverage Doctrine

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- A policy exclusion or limitation that “**swallows**” all or virtually all of a coverage grant renders the coverage “illusory,” in which case the exclusion or limitation will not be enforced.
- If some portion of coverage remains after enforcement of the exclusion, then the coverage grant is not “illusory,” and the exclusion or limitation is enforceable.



# What is the scope of the “Coverage Grant” by which “illusory” coverage is measured?

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- How “big picture” or “granular” is the analysis of the relevant “coverage grant”?
  - The entire policy?
  - Individual coverage parts?
  - Individual endorsements that extend coverage?



# At what point is the remnant of remaining coverage so insubstantial that the coverage is illusory?

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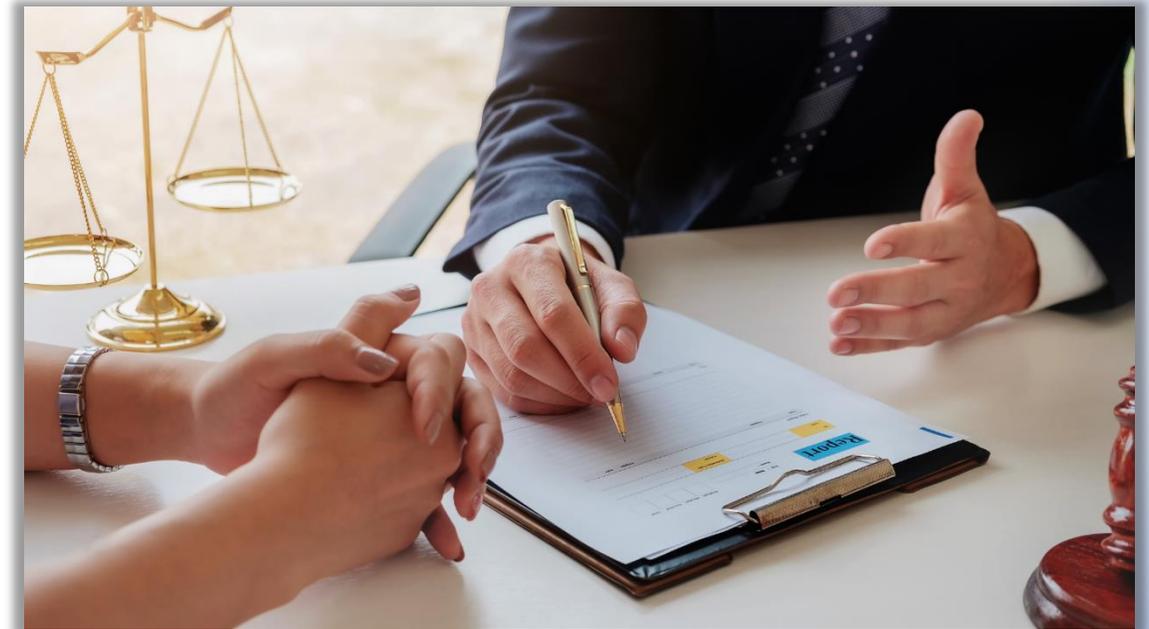
- Does it suffice that there is some abstract vestige of coverage that remains?
- Does the analysis include consideration of the nature of the insured's actual business and the types of risks that it ordinarily encounters?



# Other Considerations

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- Whether a particular portion of the premium was allocated to the type of coverage that is negated by the policy exclusion
- Underwriting and negotiating history:
  - Was the insured aware of the exclusion before the policy was issued?
  - Was the insured given a choice of purchasing that particular type of coverage for a higher premium?
  - Is this a standard exclusion that invariably is included in policies of this type?



# 1<sup>st</sup> Hypothetical

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- Policyholder operates a nightclub.
- Altercation between two patrons; bouncer removes both from bar; leaves them in parking lot.
- Fight ensues; one patron kills other.
- Suit brought by family of deceased patron against nightclub, owner, bouncer and alleged assailant.
- Nightclub seeks coverage under CGL policy.



# Assault and Battery Exclusion

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No coverage for any claim:

**“arising out of assault and/or battery, or out of any act or omission in connection with the prevention or suppression of such acts, including negligent training or supervision . . .”**

Suit seeks damages for bodily injury, claiming failure to provide adequate security. Policyholder argues exclusion renders policy illusory.

What if . . .

- Restaurant instead of nightclub?
- Exception for Self Defense?



# Absolute Liquor Exclusion

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Coverage under the policy does not apply to:

**“bodily injury or property damage arising out of or in connection with the manufacturing, selling, distributing, serving or furnishing of any alcoholic beverages.”**

What if . . .

- Patron slipped and fell on a wet floor on way into bar? After having a drink at the bar?
- Can there be an accident involving bodily injury in a bar that is in no way connected to furnishing alcohol?



# 2<sup>nd</sup> Hypothetical

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- Policyholder is a general contractor.
- Sued by building occupants claiming illness from mold exposure.
- Policyholder tenders claims to CGL insurer under Completed Operations coverage.
- Policy does not have a mold or fungus exclusion.



# Insurer denies Coverage based on a Health Hazard Exclusion

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- No coverage is available for any claim arising from:  
“... the exposure to, ingestion of, absorption of, or existence of any Health Hazard.”
- Health Hazard is defined as:  
“Any product or substance that is alleged or determined to be harmful.”
- Policyholder argues that the exclusion renders the Completed Operations coverage “illusory.”

# What If...

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- Instead of injuries from mold exposure, the injuries arose from the collapse of a support beam due to faulty construction.
- The insurer argues that the exclusion applies because the claim arose from the “existence” and/or “exposure to the allegedly harmful supporting beam.”
- Does that application of the exclusion render the Completed Operations coverage illusory?



# What If...

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- Return to the mold exposure scenario.
- The exclusion only applied to the **“ingestion, inhalation, or absorption”** of a **“hazardous substance”** – i.e., the words **“exposure”** and **“existence”** are omitted from the exclusion.
- Does that alter the **“illusory coverage”** analysis?

# What If...

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- The Health Hazard exclusion instead barred coverage for claims arising from:

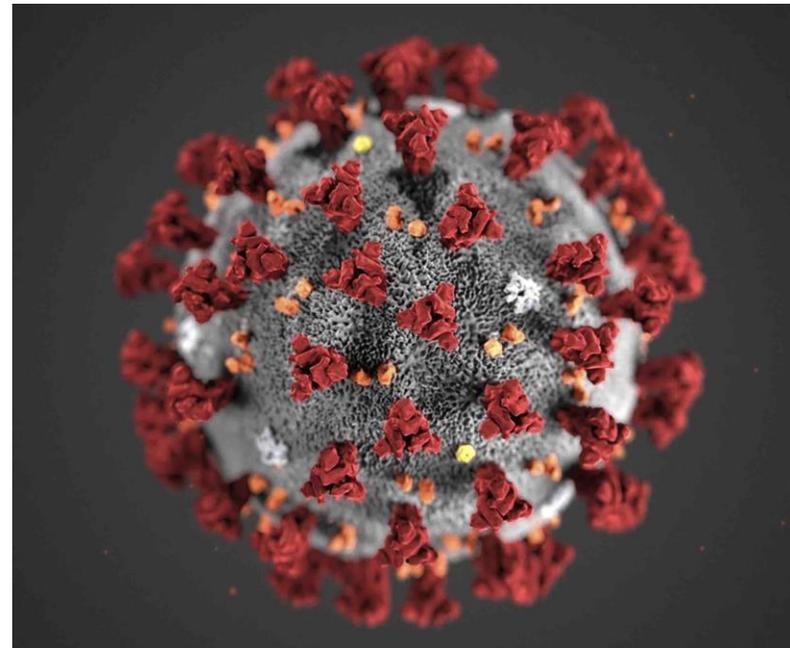
... the discharge, dispersal, seepage, migration, release or escape of pollutants, asbestos, silica, mold, fungi, and materials containing those substances

- Does that exclusion render the Completed Operations coverage illusory?

# COVID Claims and Litigation

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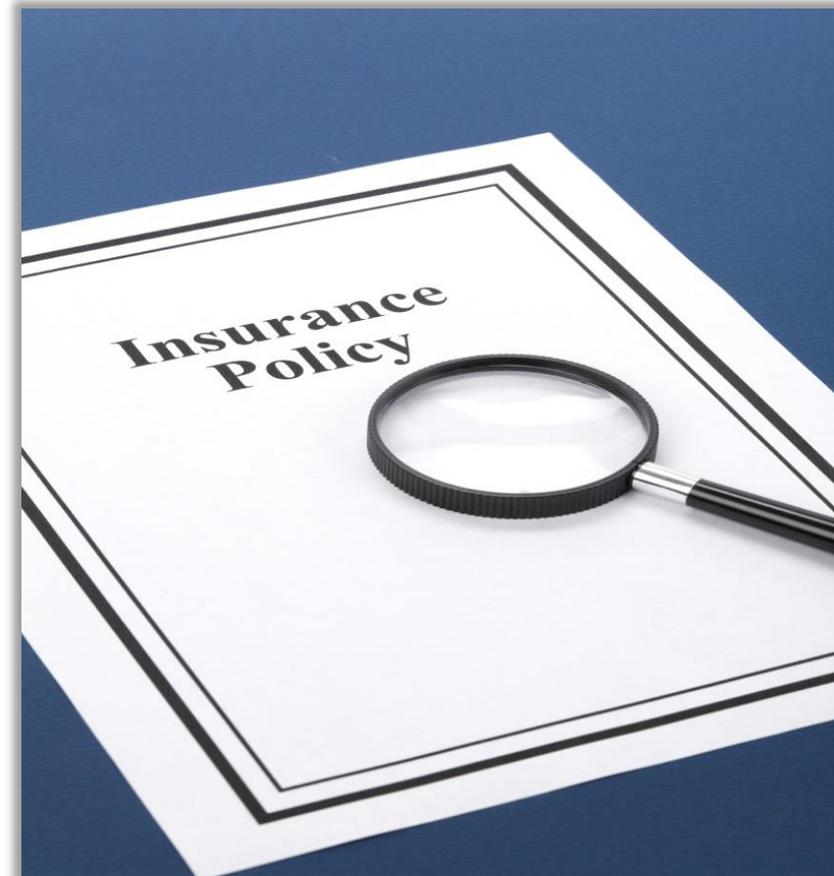
- COVID coverage litigation mainly focuses on whether COVID can cause **“direct physical loss of or damage to”** property.
- However, certain coverage extensions, endorsements, or other corollary language in commercial property policies have been the focus of illusory coverage arguments by policyholders.



# What If...

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- A policy has a specific coverage extension for losses caused by **“microbes”** - defined to include **“virus.”**
- Extension provides coverage for:  
**“direct physical loss of or damage to covered property caused by . . . microbes,”** including the cost of removing the microbes, so long as the microbes are the direct result of a covered peril.



# Microbe Extension

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- If insurer was required under the extension to pay for “direct physical loss of or damage to covered property caused by . . . microbes,” does that mean microbes/viruses can cause “direct physical loss or damage?” If not, then is the coverage extension illusory?
- Does it matter that there are certain types of microbes that cause physical loss or damage, i.e., that , ones that involve persistent physical contamination requiring repair or rendering the property unusable?
- Does it matter whether the insured’s particular business is at risk for those latter types of microbes?

# What If...

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- An endorsement covers virus-caused property damage if it arose from a “specified cause of loss,” which encompasses:

windstorm or hail; smoke; aircraft or vehicles; riot or civil commotion; vandalism; sinkhole collapse; volcanic action; falling objects; weight of snow or ice; water damage, sprinkler leakage; theft; or building glass breakage.

- Is it possible for any of these events to give rise to a viral contamination?



# Virus Endorsement

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- Are abstract scenarios in which virus could cause damage to property under one of these “specified causes of loss” sufficient to defeat the illusory coverage argument?
- Is the policyholder’s illusory coverage argument defeated by the availability of coverage for a wind-blown viral infection of livestock?
- What if the policyholder is a restaurant in an urban center with the virus extension quoted above?

# Last Hypothetical

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- Policyholder is a bar.
- Sued for claims such as defamation and invasion of privacy for the unauthorized use of photographs in advertisements.
- Tendered claim to CGL insurer Coverage B.



# Last Hypothetical

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## Endorsement contained a “Field of Entertainment” exclusion:

This insurance does not apply to any loss, claim, “suit”, cost, expense, or liability for damages, directly or indirectly based on, attributable to, arising out of, involving, resulting from or in any way related to:

- a. Actual or alleged activity which is claimed to be an intellectual property infringement or violation of any of the following rights or laws: copyright, patent, trade dress, trade secrets, trade name, trademark or service mark;
- b. Actual or alleged invasion of privacy;
- c. Actual or alleged libel, slander, or any form of defamation;
- d. Actual or alleged unauthorized use of titles, slogans, names, formats, ideas, characters, artwork, theme, plots or other material;
- e. Actual or alleged infringement of copyright or common law rights in literary, artistic or musical material, or actual or alleged infringement of literary, artistic or musical rights codes;

In other words, the exclusion wiped out all the advertising injury provisions and the court had to decide between a policy form that covered advertising injury and an endorsement that eliminated it.

# Last Hypothetical

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- Is there any ambiguity between these two worlds? What's different here from the standard view that an endorsement controls over conflicting policy language?
- Would the carrier have been better off trying to accomplish this by modifying the limits in the declarations page to put in a split limit for personal and advertising injury, with \$0/--/NCP on advertising side?
- How about arguing the title? It says "entertainment," but only (d) and (e) seem directly focused on entertainment.

# Conclusions

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- Less “sophisticated” policyholders are more likely to prevail.
- Where the “illusory” coverage grant is contained an endorsement or extension, the illusory coverage argument is easier.
- If the remnant of coverage that remains is not relevant to the insured’s actual business, the illusory coverage argument is easier.
- Standard exclusions or limitations – like “prior acts” dates or the total pollution exclusion – are difficult to attack.



# Questions?

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