

Severability Clause Does Not Limit Cross-Liability Exclusion

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The United States District Court for the Northern District of Illinois has held that a liability policy's severability clause did not alter the broad application of the policy's cross-liability exclusion to "any insured," and therefore the exclusion barred coverage for a lawsuit filed by the policyholder's employee against an additional insured under the policy. *Archer Daniels Midland Co. v. Burlington Ins. Co. Group, Inc.*, 2011 WL 1196894 (N.D. Ill. Mar. 29, 2011).

The policyholder, a building maintenance company, provided window cleaning services to a client. As required by their contract, the company's liability policy included an endorsement naming the client as an additional insured. During the policy period, an employee of the maintenance company injured his knee while cleaning windows for the additional insured. The employee thereafter filed suit against the additional insured. The additional insured tendered the defense to the insurer, which initially accepted the defense but weeks later disclaimed any defense obligation. In the ensuing coverage litigation, the insurer asserted that the policy's employer's liability exclusion and cross-liability exclusion each barred coverage. The employer's liability exclusion precluded coverage for bodily injury to "an 'employee' of the insured arising out of and in the course of ... [e]mployment of the insured" regardless of "[w]hether the insured may be liable as an employer or in any other capacity." The cross-liability exclusion precluded coverage for injury to "[a] present, former, future or prospective ... employee of any insured." The additional insured asserted that the policy's severability clause modified these exclusions such that coverage for the underlying suit—asserted by an individual that was not one of its employees—was preserved. The severability clause provided that coverage applied "[a]s if each

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Named Insured were the only Named Insured” and “[s]eparately to each insured against whom a claim is made or ‘suit’ is brought.”

Ruling on the insurer’s motion to dismiss on the pleadings, the court first found that the severability clause did limit application of the employer’s liability exclusion only to cases in which the injured person sues his or her employer. Because the employer’s liability exclusion expressly barred coverage for bodily injury sustained by “an ‘employee’ of *the* insured,” the court held, the exclusion would not apply to the suit filed by the underlying plaintiff, given that he was not an employee of the insured he sued—the additional insured corporation. In reaching this conclusion, the court pointed out that the purpose of the employer’s liability exclusion is to preclude coverage for bodily injury claims asserted by an insured’s own employee because they are covered under the worker’s compensation system, and the insured should not recover twice.

In contrast, however, the court held that the severability exclusion did not modify the cross-liability exclusion to limit it to claims asserted against an insured by the insured’s own employee. The court noted that the cross-liability exclusion barred coverage for injury sustained by the an employee of “*any* insured” and not only “*the* insured.” The court explained that the distinction between such terms is plain and “crucial to determining the import of a severability clause,” especially given that the terms are used in different exclusions within the same policy. Because the exclusion barred claims asserted by an employee of “any insured,” the court held, it applied to bar the underlying plaintiff’s suit against the additional insured, given that he was an employee of an insured (the policyholder). The court further explained that, unlike with the employer’s liability exclusion, the purpose behind the cross-liability exclusion—to prevent one insured (or its employee) from suing another insured (or its employee)—did not support a conclusion that the severability clause limited its application.

Given the court’s determination that the insurer owed no duty to defend, the court further rejected the additional insured’s argument that the insurer was estopped from asserting coverage defenses. Finally, the court rejected the additional insured’s claim for statutory penalties based on vexatious or unreasonable conduct, holding that the insurer promptly and properly rescinded its initial acceptance of a defense.