

Spring, 2022

AEI CLAIMS LAW QUIZ

SEPARATION OF INSUREDS EFFECT ON EMPLOYER'S LIABILITY EXCLUSION

[*Ref. Law of Insurance: General Liability, Paras. 2.08 & 3.03*]

FACTS: Desjean was injured while working on a construction project on property owned by Nagog Homes (Homes). Nagog Real Estate (Real Estate) was the general contractor and Desjean was employed by a subcontractor. Desjean initially sued Homes and an employee of Real Estate, but later amended the complaint to join Real Estate as a defendant. It was unclear whether Desjean's employer had been hired by Homes or Real Estate. The suit alleged a variety of negligence theories against the defendants.

Nautilus Insurance had issued a commercial package policy to Homes and Real Estate, which included general liability coverage (CGL). Real Estate requested that Nautilus provide it with a defense and Nautilus refused based on an L205 Exclusion endorsed to the policy. The endorsement excluded coverage for "bodily injury to any insured's, contractors' or subcontractors' or independent contractors' employees arising out of and in the course of employment by any insured or directly or indirectly performing duties related to the conduct of any insured business." Real Estate filed a declaratory judgment action asserting that Nautilus owed it a defense in the underlying suit based on the separation of insureds policy condition, under which each insured was to be treated as if it had a separate insurance policy.

QUESTION: Did the separation of insureds condition negate the effect of the word "any" in the endorsed policy exclusion and trigger the insurer's duty to defend?

ANSWER: No. The court in *Nagog Real Estate Consulting Corp. v. Nautilus Insurance Co.*, 474 F. Supp. 3d 459 (D. Mass. 2020), held that the endorsement's exclusion was not negated by the policy's separation of insureds condition. The endorsement clearly changed the policy and replaced the employer's liability exclusion, which only excludes coverage for bodily injury to an employee of "the insured," with a broader exclusion, which bars coverage for bodily injury sustained by an employee of "any insured."

Initially the court considered whether the underlying suit triggered coverage under the CGL. By alleging negligently caused bodily injury, the suit fell within the coverage provided by the policy – sufficient, at least initially, to trigger the duty to defend. The coverage inquiry, however, did not end there. The insurer had the right to dispute coverage based on the policy exclusions.

Nautilus argued that by virtue of the endorsement, coverage was excluded for injuries to an employee of “any insured” so it didn’t matter which insured was the claimant’s employer. Real Estate argued that the separation of insureds condition in the policy acted to defeat the “any insured” language of the L205 Endorsement.

The court then considered the separation of insureds language, which provided that the insurance applied “as if each named insured were the only named insured.” It also provided that coverage applied “separately to each insured against whom claim is made or suit is brought.” Nautilus argued that the endorsed exclusion was a bar to coverage despite the severability of interests or separation of insureds condition because the exclusion applied broadly to claims brought by an employee of any insured. Nautilus reasoned that since both Homes and Real Estate were insureds under the policy, coverage was barred regardless of which of them was the plaintiff’s employer.

The court observed that the question of whether a separation of insureds condition negated a policy exclusion had been considered by numerous courts with differing results. Looking to Massachusetts law, the policy language had to be interpreted to give reasonable meaning to both the exclusion and the separation of insureds condition. The court was required to give reasonable meaning to all of the policy provisions. The court explained:

Here, a literal reading of the L205 Endorsement by itself would preclude coverage. The Underlying Suit alleges that Desjean was an employee of Nagog Homes and/or Nagog Real Estate, both of which are insured under the Policy and the L205 Endorsement bars coverage for injuries of employees of “any insured.” The L205 Endorsement differs from the employer’s liability provision it alters in the general terms in several respects. One of the main differences between the L205 Endorsement and the Employer’s Liability provision in the general terms is that the L205 Endorsement replaces the term “that insured” with “any insured.” This replacement alters the exclusion so that instead of excluding coverage only for bodily injury to employees of “that insured” seeking coverage, the L205 Endorsement broadens the exclusion to exclude bodily injury to employees of “any insured” under the policy.

Reading the separation of insureds provision to apply to the L205 Endorsement would require that “each insured be treated as having a separate insurance policy,” which would negate the change in the L205 Endorsement of the term “that insured” to “any insured.” The L205 Endorsement states that it “changes the policy” and “modifies” the policy and further instructs the signatory to “read it carefully.” The court is obligated to interpret the Policy in a manner which “best effectuates the main manifested design of the parties,” and it appears that the manifest design of the parties was to broaden the employee injury exclusion to bar coverage of injuries suffered by the employees of any insured under the Policy. Accordingly, whereas here the endorsement expressly states it “modifies the insurance policy” by replacing “the insured” with “any insured,” ... “it should be read to supersede the separation of insureds language in order both to effectuate its plain meaning and to avoid rendering the clause a nullity.”

The court concluded that the insurer intended the term “that insured” to have a different meaning than the term “any insured.” Because application of the separation of insureds condition would result in a rejection of these different meanings, the separation of insureds condition was not intended to be applied to the endorsed exclusion. The policy, because of the endorsement, excluded coverage for claims of bodily injury to employees, contractors’ employees, subcontractors’ employees, or workers of any insured when the injury arose out of and in the course of employment by any insured. The court held that Nautilus had no obligation to defend Real Estate.

CONCLUSION: A standard CGL employer’s liability exclusion bars coverage for the insured employer in a bodily injury claim by its employee that arises out of the employment. Under that language, a co-insured who is not the injured employee’s employer can be entitled to coverage.

As with the situation in *Nagog Real Estate*, however, it is not uncommon for a CGL insurer to include an endorsement that expands the scope of the employer's liability exclusion to bar coverage of employment injury claims brought by an employee of "any insured." The rationale for the exclusion is that these kinds of employee injury claims are intended to be covered under the employers liability coverage of a workers' compensation policy.

Whether or not an employer's liability exclusion will bar coverage for a claim by an employee against an insured, despite the employment relationship between the two or lack thereof, will depend on the facts of the case, the policy language at issue, and how a court interprets it. Familiarity with how your jurisdiction has interpreted the language of the policy exclusion and the severability clause at issue is vital to the proper handling of a liability claim brought by an employee.