RECONCILING THE IRRECONCILABLE CONFLICT IN INSURANCE SEVERABILITY OF INTERESTS CLAUSE INTERPRETATION

JOHNNY PARKER*

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This article explores the inconsistency with which courts interpret severability of interest clauses in insurance policy exclusions. The article explores the severability of interest clauses and discusses the rules that courts employ to interpret such clauses. Specifically, the article outlines three methodologies of contract interpretation used by courts when faced with severability of interest clause controversies and each method's strengths and weakness. The article concludes that behind the different interpretive methods lie two schools of thought amongst the courts, those who follow a "traditional or formalist" approach and those who follow a "functional or reasonable expectations" approach.

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I. INTRODUCTION

Typically, a policy of insurance affords coverage to multiple insureds – those being the named insured, as well as individuals considered to be insureds as a result of their relationship with the named insured. When one or more, but fewer than all, of the insureds being sued actually engaged in conduct excluded from coverage in the policy, a controversy can ensue as to whether an exclusion from coverage, which is clearly applicable to one insured, operates to preclude all insureds – including innocent co-insureds – from coverage under the policy. This issue is further complicated by the inclusion in the policy of a severability of interests clause, which typically provides that the insurance applies separately to each insured.[1] Innocent co-insureds may argue that such a

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*Professor of Law, Tulsa University Law School. B.A., University of Mississippi, 1982; J.D., University of Mississippi Law School, 1984; LL.M., Columbia University Law School, 1987.

[1] The severability of interest clause was first included in insurance policies in 1955, when the National Bureau of Casualty Underwriters and the Mutual Rating Bureau revised the standard provisions and included the clause as a new condition. The provision was designed to correct prior judicial interpretations which construed the term "the insured" to preclude coverage to all insureds when any co-insured was excluded from coverage in the policy. Subsequent revision of the language used in the severability of interest clause sought to express this purpose

severability of interests clause overrides any exclusion to coverage as applied individually to them.

In practical terms, a dispute over a severability of interests clause involves an innocent co-insured who is sued in conjunction with, and as a consequence of, a culpable insured's conduct. The insurance company, upon receipt of a notice of claim from the innocent co-insured, denies coverage under the policy on the basis that because the conduct of a culpable insured is expressly excluded, the claim of the innocent co-insured is similarly excluded from coverage. The innocent co-insured takes the position that regardless of the excluded conduct of another insured, she is nevertheless entitled to coverage because of the presence of a severability of interests clause in the policy.

Severability clause disputes can arise from a myriad of factual situations. For example, in *Co-Operative Ins. Co. v. Bennett*,[2] Michael Jacques allegedly kidnapped his twelve-year-old niece, Brooke Bennett, and transported her to his home in Randolph, Vermont where he "drugged, sexually assaulted, and murdered her."[3] At that time, Michael was married to Denise Woodward, who lived with him in the Randolph house. Denise was not involved in the kidnapping or subsequent events. Nevertheless, Brooke's estate and father sued Denise for having "negligently failed to: (1) supervise minor children while they were in the home, (2) warn the Bennett family of the dangers posed by her husband, and (3) prevent the harm from occurring."[4]

Both Michael and Denise were named insureds on a homeowners' policy issued by Cooperative Insurance Company ("Cooperative"). Denise tendered the claim to Cooperative, which filed a declaratory judgment action against Denise and plaintiffs in the underlying tort action on the grounds that its homeowners' policy excluded from coverage "bodily injury" or "property damage": "(1) which is expected by, directed by, or intended by an 'insured'; (2) that is the result of a criminal act of an 'insured'; or (3) that is the result of an intentional or malicious act by or at the direction of an 'insured.'"[5] The policy also provided that each insured "is a separate 'insured,' but this does not increase 'our' limit."[6]

The issues in *Cooperative* were whether a severability clause creates an ambiguity when read together with an intentional acts exclusion and whether such ambiguity must be resolved in favor of coverage.

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even more clearly. Norman E. Risjord & June M. Austin, "*Who Is 'The Insured'" Revisited*, 28 INS. COUNS. J. 100, 100–101 (1961).

[2] No. 168-8-10 Oecv, 2011 Vt. Super. LEXIS 35 (Apr. 11, 2011), *aff'd sum nom*. Co-Operative Ins. Cos. v. Woodward, 2012 VT 22 (2012).

[3] Co-Operative Ins. Cos., 2011 Vt. Super. LEXIS 35, at * 3.

[4] *Id.* at *4.

[5] *Id.* at *5.

[6] *Id.* at *6.

Defendants—Denise Woodward, along with Brooke Bennett's estate and father—argued that the severability clause created an expectation that the intentional acts exclusion would be applied separately to each insured and that this expectation created an ambiguity when compared with the language of the exclusion.

According to the court, a severability clause does not create an ambiguity in an otherwise clear and unambiguous exclusion for three reasons. First, even though a severability clause may mean that the insurance policy applies separately to each insured, it does not change the fact that the policy contains an exclusion.[7] Consequently, the severability clause "cannot create coverage where none exists."[8] In other words, "the act of applying the policy separately to each insured does not alter or create ambiguity in the substance or sweep of the exclusion."[9] Second, the majority of jurisdictions had adopted the view that "a severability clause does not alter the collective application of an exclusion for intentional, criminal, or fraudulent acts by 'an' or 'any' insured."[10]

Co-Operative Ins. Co. v. Bennett represents one factual extreme - heinous harm to person - on the severability dispute spectrum. The opposite end of the factual spectrum - juvenile vandalism to property - is illustrated by *Chacon v. American Family Mutual Insurance Company.*[11] *Chacon* arose out of the vandalism of an elementary school by the Chacons' ten-year-old son Nicholas and another boy.[12] The vandalism caused damage in excess of $6,000.[13] The school district's insurer paid for the damage and filed suit against the Chacons for reimbursement.[14] Prior to this lawsuit, the Chacons filed a claim relating to the damage caused by Nicholas under their homeowners' policy provided by American Family.[15]

The Chacons were the named insureds in the policy, which defined "insured" to include "your relatives if residents of your household. . . . [or] any other person under the age of 21 in your care or in the care of your resident relatives."[16] The policy further provided that "each person described above is a separate insured under this policy."[17] It also contained a severability clause, which stated "this insurance applies separately to each

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[7] *See id.* at *17.

[8] Co-Operative Ins. Cos., 2011 Vt. Super. LEXIS 35, at *17.

[9] *Id.* at *19 (quoting SECURA Supreme Ins. Co. v. M.S.M., 755 N.W.2d 320, 329 (Minn. Ct. App. 2008).

[10] *Id.* at *17–18 (quoting Minkler v. Safeco Ins. Co. of Am., 232 P.3d 612, 623 (Cal. 2010)).

[11] 788 P.2d 748 (Colo. 1990).

[12] *Id.* at 749.

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.* at 750.

[17] *Id.*

insured. This condition will not increase our limit of liability for any one occurrence."[18]

The Chacons' claim, since it resulted from the actions of their son, was within the scope of coverage provided by the policy. Nicholas was also an additional insured under the policy as a minor in their care. American Family, however, argued that coverage was excluded by the intentional acts exclusion which provided that personal liability coverage does "not apply to bodily injury or property damage . . . which is expected or intended by any *insured*."[19]

According to American Family, the exclusion clearly and unambiguously excluded coverage to all insureds when any individual insured caused property damage that was "expected or intended." The Chacons asserted that American Family's position failed to give effect to the severability clause contained in the policy. They argued that the clause created separate insured status for each insured, which required that the exclusion be applied independently to each.

Under the guise of ascertaining the intentions of the parties, the Court engaged in an objective evaluation of what a reasonable person would have understood the contract to mean.[20] The purported advantage of this approach was that it considered and gave effect to all the policy provisions and recognized that an insurance policy is a contract between the parties, which should be enforced in a manner consistent with the intentions expressed therein.[21] Pursuant to this reasoning, the Court concluded that an exclusion containing the term "any insured" clearly and unambiguously expressed an intent to deny coverage to all insureds when damage was intended or expected as a result of the actions of any one of them.[22]

Between these two factual extremes lie a myriad of cases involving every type of insurance policy and factual circumstances imaginable. This article examines the impact of a severability of interests clause on insurance policy exclusions. Its objective is to ascertain and explain the reasoning that makes this area of insurance law seemingly irreconcilable. Section I introduces the severability of interests clause. It uses several factual situations to illustrate and provide a context for severability clause disputes. Section II discusses the rules of insurance contract interpretation. It explores how these rules are employed in the context of severability clause disputes. Section II demonstrates that in the context of severability disputes the rules of contract interpretation are applied in ways which support the recognition of several distinct interpretive methodologies.

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[18] *Id.*
[19] *Id.*
[20] *See id.* at 752.
[21] *Id.*
[22] *Id.*

Section III discusses the interpretive methodologies from the perspective of two competing theories of contract interpretation. Section III explains the strengths and weakness of the various methodologies in the context of these theories. Section IV concludes that the severability of interests clause interpretative landscape has been shaped by two diametrically opposite judicial philosophies, the traditional approach and the functional approach. I argue that the perception that severability clause jurisprudence is irreconcilable is misplaced and that reconciliation in this subject area can be achieved by adherence to the functional or reasonable expectation approach to contract interpretation.

II. SEVERABILITY CLAUSE JURISPRUDENCE

Severability clause jurisprudence has evolved on a variety of fronts. The first is the basic principles used by courts to interpret insurance contracts. All courts agree that the primary objective of insurance policy interpretation is to ascertain and give effect to the intentions of the parties.[23] Except in cases of ambiguity, this process typically begins with the language of the policy.[24] In this context, the words are to be accorded their plain and ordinary meaning and usage,[25] as ascertained from a standard English dictionary.[26] Where possible, an insurance policy should be interpreted in a manner which gives reasonable meaning to all of its provisions.[27] Courts, in ascertaining the intention of the parties, are at liberty to consider the intent and purpose of both the exclusion and

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[23] *See* State Farm Fire & Cas. Co. v. Hooks, 853 N.E.2d 1, 5 (Ill. App. Ct. 2006); T.B. v. Dobson, 868 N.E.2d 831, 836 (Ind. Ct. App. 2007); American Family Mut. Ins. Co. v. Corrigan, 697 N.W.2d 108, 111 (Iowa 2005); Brumley v. Lee, 963 P.2d 1224, 1226 (Kan. 1998); K.M.R. v. Foremost Ins. Grp., 171 S.W.3d 751, 753 (Ky. Ct. App. 2005); Pa. Nat'l Mut. Cas. Ins. Co. v. Bierman, 292 A.2d 674, 677 (Md. Ct. Spec. App. 1972); Travelers Ins. Co. v. American Cas. Co. of Reading, Pa., 441 P.2d 177, 180 (Mont. 1968); Erdo v. Torcon Constr. Co., 645 A.2d 806, 808 (N.J. Super. Ct. App. Div., 1994); Madison Constr Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 106 (Pa. 1999).

[24] *See Chacon*, 788 P.2d at 750; *Hooks*, 853 N.E.2d at 5; K.M.R. v. Foremost Ins. Grp., 171 S.W.3d 751, 753 (Ky. Ct. App. 2005); *Erdo*, 645 A.2d 806 at 808.

[25] *See* Essex Ins. Co. v. City of Bakersfield, 154 Cal. App. 4th 696, 7 (Cal. Ct. App. 2007); Farmland Indus. v. Republic Ins. Co., 941 S.W.2d 505, 508 (Mo. 1997).

[26] *See Farmland Indus*, 941 S.W.2d at 508; R.T. Vanderbilt Co. v. Continental Cas. Co., 870 A.2d 1048, 1059 (Conn. 2005).

[27] *See* Cicciarella v. Amica Mut. Ins. Co., 66 F.3d 764, 767 (5th Cir. 1995); Amer. Family Mut. Ins. Co. v. White, 65 P.3d 449, 454 (Ariz. Ct. App. 2003); Valero v. Florida Ins. Guar. Ass'n, Inc., 59 So.3d 1166, 1169 (Fla. Dist. Ct. App.2011); *Hooks*, 853 N.E.2d at 5; *Dobson*, 868 N.E.2d at 836; Benton v. Canal Ins. Co., 130 So.2d 840, 846 (Miss. 1961).

severability clause in the context of the type of policy at issue. Furthermore, in cases of first impression, courts may also be guided in their reasoning by precedents from other jurisdictions.

When an insurer proffers a policy exclusion as a basis for denying coverage, it asserts an affirmative defense for which it has the burden of proof.[28] To prevail, the insurer must prove that the language of the insurance policy is clear and unambiguous.[29] Otherwise, the provision should be construed in favor of coverage.[30]

Application of these rules in the context of severability clause disputes has resulted in three distinct interpretive methods. These interpretive methods share only one common thread. That being that each, in drastically different ways, purports to enforce the intention of the parties to the contract in the context of exclusions couched in terms of "an insured" or "any insured." The differences between the interpretative methodologies are reflected in whether the terms "an insured" and "any insured" are viewed as synonymous or distinct and whether the presence of a severability clause modifies or creates an ambiguity in the exclusion.

While the insurance industry's preference has been to refer to excluded conduct from the perspective of "an" or "any" insured, some insurance companies use different and more specific language to describe what is excluded from coverage. For example, in *Ristine v. Hartford Insurance Co.*, Barbara Ristine and her minor daughter, L., sued David and Carol Purcell, alleging that David had sexually molested L. on repeated occasions while she spent the night at their home.[31] The complaint alleged that Carol was negligent in failing to disclose to the plaintiffs that David was a convicted child molester and in allowing him to be alone with L.[32]

The Purcells notified their homeowners' insurance carrier – The Hartford – of the claim and requested a defense. The Hartford refused the tender on the basis of a policy exclusion excepting from bodily injury or property coverage any claims "[a]rising out of sexual molestation, corporal punishment or physical or mental abuse."[33] The Ristines ultimately settled

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[28] *See* First Specialty Ins. Corp., Inc. v. Flowers, 644 S.E.2d 453, 455 (Ga. Ct. App. 2007); Lucas v. Deville, 385 So.2d 804, 819 (La. Ct. App. 1980); Thommes v. Milwaukee Mut. Ins. Co., 622 N.W.2d 155, 880 (Minn. 2001); Flomerfelt v. Cardiello, 997 A.2d 991, 1004 (N.J. 2010); Madison Constr. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 106 (Pa. 1999); American Family Mut. Ins. Co. v. Purdy, 483 N.W.2d 197, 199 (S.D. 1992).

[29] *See* Madison Constr. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 106 (Pa. 1999); *Cicciarella*, 66 F.3d at 767 (proposing that language is ambiguous when its meaning is uncertain and doubtful or when it is reasonably susceptible of more than one meaning).

[30] *See Cicciarella*, 66 F.3d at 768.

[31] 97 P. 3d 1206, 1207 (Or. Ct. App. 2004).

[32] *Id.*

[33] *Id.*

their lawsuit against Carol Purcell. As a part of the settlement, Carol assigned to them her rights against The Hartford.

The Hartford asserted that the exclusion was unambiguous and that when compared to other exclusions, in policies using the terms "an insured" or "the insured," the language in the policy manifested an intent to exclude all claims arising out of sexual molestation, regardless of who committed the acts.[34] In other words, the exclusion was specifically designed to identify and exclude a particular act, as contrasted with exclusions that identify and exclude on the basis of the actor by using terms such as – "the insured," "an insured" or "any insured." Therefore, all claims arising out of the specified act – sexual molestation – were precluded, without regards to the identity of the actor.

The court agreed with the Hartford that the absence of terminology – such as "the insured," "an insured," or "any insured" – identifying an actor demonstrated that the insurer intended to base the exclusion on the nature of the act, rather than on the identity of the actor.[35] Consequently, even though the severability clause made the provisions of the policy separately applicable to David and Carol, it did not affect the sexual molestation exclusion because it contained no qualifications relative to the identity of the actor.[36]

The impact of a severability clause on an exclusion depends on the interpretive methodology used by the court. For example, in some jurisdictions the terms "an insured" and "any insured" are viewed as synonymous and are not modified by the presence of a severability clause. Thus, all insureds are precluded from coverage because of the excluded conduct of any one insured. I will refer to this as "Methodology No. 1." However, in other jurisdictions which also treat the terms as synonymous, the principle of ambiguity is applied to achieve coverage in light of the inclusion of a severability clause. This approach will be referred to as "Methodology No. 2." A number of jurisdictions reject the conclusion that the terms "an insured" and "any insured" are synonymous when used in an exclusion. Some jurisdictions that follow this view consider the former phrase to be modified by a severability clause while the latter is not ("Methodology No. 3a"). Others reach the same result by construing the phrase "an insured" as ambiguous when read in conjunction with a severability clause while "any insured" is unaffected ("Methodology No. 3b").

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[34] *Id.* at 1209.
[35] *See id.*
[36] *Id.*

A. METHODOLOGY NO. 1

Under this methodology, courts construe an insurance policy exclusion that is couched in the words "an insured" or "any insured" to apply to all the insureds and additionally hold that a severability clause has no impact on that exclusion. This conclusion results when courts accord greater weight to the precise language – "an insured" or "any insured" – of the exclusion.[37] Courts following this approach sometimes rule that an absurd or repugnant interpretation should not result from construing the policy to give effect to the severability clause.[38] Under this line of thinking, an absurd or repugnant result would occur when the application of the severability clause would convert the policy purchased into a different type which the insured neither negotiated nor paid for or would otherwise enlarge the obligation originally undertaken by the insurer and permit a windfall to the insured.[39]

The dominant rationale for this approach is that the purpose of the severability clause is to spread protection to the limits of coverage, among all insureds, not to negate bargained-for exclusions.[40] Consequently, a collective effect, pursuant to which the excluded act of one insured precludes coverage for all, is accorded the exclusion if it is "specific" or imposes a joint obligation on the insureds.[41] Some courts construe the use of the terms "an insured" or "any insured" as unambiguously creating a

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[37] *See, e.g.*, Johnson v. Allstate Ins. Co., 687 A.2d 642, 644 (Me. 1997); K.M.R. v. Foremost Ins. Grp., 171 S.W.3d 751 (Ky. Ct. App. 2005); Nat'l Ins. Underwriters v. Lexington Flying Club, Inc., 603 S.W.2d 490 (Ky. Ct. App. 1979); Liberty Mut. Ins. Co. v. State Farm Mut. Auto., 522 S.W.2d 184 (Ky. Ct. App. 1975); Gorzen v. Westfield Ins. Co., 526 N.W.2d 43 (Mich. Ct. App. 1994); Home Owners Ins. Co. v. Selfridge, No. 280112, LEXIS 2504 (Mich. Ct. App. December 18, 2008), McAllister v. Millville Mut. Ins. Co., 640 A.2d 1283 (Pa. Super. 1994): Caroff v. Farmers Ins. Co. of Washington, 261 P.3d 159, 163 (Wash.App. Div. 11999); Co-Operative Ins. Cos. v. Bennett, No. 168-8-10 Oecv, April 11, 2011 Vt. Super. LEXIS 35.

[38] *See* Oaks v. Dupuy, 653 So.2d 165 (La. Ct. App. 1995); Shelter Mut. Ins. Co. v. Haller, 793 S.W.2d 391 (Mo. Ct. App. 1990); B.P. Am., Inc. v. State Auto. Prop. & Cas. Ins. Co., 148 P.3d 832 (Okla. 2005); Transit Cas. Co. v. Hartman's Inc., 239 S.E.2d 894 (Va. 1978).

[39] *See B.P. Am., Inc*. 148 P.3d at 837–39; *Transit Cas. Co*. 239 S.E.2d at 897.

[40] *See* Northwest G.F. Mut. Ins. Co. v. Norgard, 518 N.W.2d 179 (N.D. 1994); Caroff v. Farmers Ins. Co., 261 P.3d 159 (Wash. App. Div. 1 1999).

[41] *See* Allstate Ins. Co. v. Kim, 121 F. Supp. 2d 1301 (D. Haw. 2010); Villa v. Short, 947 A.2d 1217 (N.J. 2008); Northwest G.F. Mut. Ins. Co. v. Norgard, 518 N.W.2d 179 (N.D. 1994); McAllister v. Millville Mut. Ins. Co., 640 A.2d 1283 (Pa. Super. Ct. 1994); Great Cent. Ins. Co. v. Roemmich, 291 N.W.2d 772 (S.D. 1980); Caroff v. Farmers Ins. Co. of Washington, 261 P.3d 159 (Wash.App. Div. 1 1999).

specific exclusion imposing a joint obligation.[42] Apart from this rule, courts otherwise have not articulated what makes an exclusion "specific" as opposed to "general."

This interpretive model was employed in the often cited case of *BP Am., Inc. v. State Auto Prop. & Cas. Ins. Company*. *BP* involved a construction contract between B.P. America, Inc. ("BP") and Doyal W. Rowland Construction, Inc. ("Rowland"). As required under a construction contract, BP obtained $1,000,000 in comprehensive general liability coverage from State Auto and Casualty Company ("Insurer"). Insurer issued two policies, listing Rowland as the named insured and BP as an additional insured. The first policy covered general liability and the second covered automotive liability. While the policies were in force, a multi-car accident occurred involving a dump truck driven by a Rowland employee. Three people died and a fourth sustained serious injuries. Multiple lawsuits were filed. In different combinations, the suits named as defendants the employee, Rowland, BP, and/or Insurer. The personal injury lawsuits settled with Insurer contributing $1,000,000 pursuant to the automotive liability policy. Thereafter, BP filed suit in federal court seeking recovery under the general liability policy. Recognizing that the lawsuit involved issues of first impression, the United States District Court for the Northern District of Oklahoma certified two questions to the Oklahoma Supreme Court:

> 1. "[w]hether, under Oklahoma Law, the term 'any insured' in an 'Auto Exclusion' clause of a commercial general liability policy excludes from coverage all automobile occurrences attributable to any of the insureds?" [and]
> 2. "[w]hether, under Oklahoma Law, the inclusion of both an 'Auto Exclusion' clause and a 'separation of insureds' clause in a commercial general liability policy creates an ambiguity in the contract?"[43]

The Court answered the first certified question in the affirmative. Influenced by the "overwhelming number of courts" which had addressed the issue, the Court concluded that the use of the term "any insured" in an exclusion unambiguously expressed a definite intent to deny coverage to all insureds.[44] According to the Court, insurers are not required to provide coverage in the absence of premium payments – as was the case – except

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[42] *See Allstate Ins. Co*., 121 F. Supp. 2d 1301; *Villa*, 947 A.2d 1217; *Northwest G.F. Mut. Ins. Co.*, 518 N.W.2d 179; *McAllister*, 640 A.2d 1283; *Great Cent. Ins. Co*., 291 N.W.2d 772; *Caroff*, 261 P.3d 159

[43] *B.P. Am., Inc.,* 148 P.3d at 833.

[44] *Id.* at 836.

where public policy demands.[45] Furthermore, a contrary interpretation would "convert a general liability policy—without [automotive] coverage—into an automotive liability policy."[46] The Court further found support for its answer to question one in Oklahoma precedents which construed the phrase "an insured," as used in an exclusion, to preclude coverage to all insureds.[47] In the process, the Court read "an insured" and "any insured" as synonymous.

With respect to the second issue, the insureds argued that, even if the exclusion was clear when read in isolation, the presence of a severability clause in the commercial policy created an ambiguity. That clause provided:

> Except with respect to the Limits of Insurance, and any rights or duties specifically assigned in this Coverage Part to the first Named Insured, this insurance applies:
> a. As if each Named Insured were the only Named Insured; and
> b. Separately as to each insured against whom claim is made or 'suit' is brought.[48]

Insurer contended, however, that to ignore the term "any insured" in the exclusion would be to render an otherwise unambiguous policy provision meaningless.

The Court reasoned that the clear intent of the parties was to preclude coverage for all insureds whenever an exclusion was applicable to "any insured." This intent was reflected not only in the exclusion's use of the phrase "any insured," but also by the fact that the parties negotiated for two different policies providing distinct coverages.[49]

Courts which rely on this interpretive method to conclude that a severability clause has no impact on the collective effect of an exclusion employing the phrase "an insured" or "any insured" typically view the phrases as synonymous.[50] The phrases are viewed as manifesting the intent of the parties to make coverage for all insureds contingent on the actions of

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[45] *Id.* at 837–38.

[46] *Id.* at 839.

[47] *See* Phillips v. Estate of Greenfield, 859 P.2d 1101, 1103 (Okla. 1993) (explaining a homeowner's policy in clear and unambiguous language excludes coverage where an injury arises out of the use of a motor vehicle owned or operated by an insured).

[48] *B.P. Am., Inc.*, 148 P.3d at 839.

[49] *Id.*

[50] Villa v. Short, 947 A.2d 1217, 1223 (N.J. 2008); B.P. Am. Inc., 148 P.3d at 839; McAllister v. Millville Mut. Ins. Co., 640 A.2d 1283, 1288 (Pa. Super. Ct. 1994).

any one insured.[51] These courts also overwhelmingly reject the argument that the language of the severability clause – "this insurance applies. . . [s]eparately as to each insured against whom claim was made"—creates an ambiguity when read in conjunction with exclusions employing either phrase.

Rejection of the ambiguity argument is typically based on one or a combination of two rationales. The first is that the severability clause is located in a different part of the policy from exclusions.[52] Consequently, the insured's sole expectation is for equal coverage.[53] The second rationale is that the use of the indefinite article "an" or "any" before insured in an exclusion clearly signals that the parties understood and intended that the exclusion would be applied collectively to bar all insureds from coverage.[54]

This interpretive method while not novel, is misguided because it ignores the reality that ambiguity in an insurance policy can arise from sources other than ambiguous language, such as inconsistent policy provisions, poor policy organization and inconsistent judicial interpretation.[55] It is also predicated on a legal fiction that a single rule of insurance contract interpretation – language used in a single provision – is dispositive of the intention of the parties. The focus of this line of reasoning is not whether the inclusion of a severability clause is inconsistent with a blanket exclusion, but "whether the contract indicates that the parties intended such a result."[56] The latter formulation allows courts to ignore the language and fundamental purpose of the severability clause. This method is strict in its reliance on a single consideration – language of the exclusion – and harsh in that it places the entire risk of loss on the insured. The most glaring flaw however, is that it provides no incentives for insurance companies to engage in better policy drafting.

B. METHODOLOGY NO. 2

The second interpretive method stands in stark contradiction to the first. It holds that while the terms "an insured" or "any insured" are synonymous, the presence of a severability clause in the policy renders the exclusion ambiguous. This ambiguity derives from the conclusion that the

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[51] *See, e.g.,* Caroff v. Farmers Ins. Co. of Wash., 261 P.3d 159, 161 (Wash. Ct. App. 1999).

[52] *See, e.g.*, Villa, 947 A.2d at 1224.

[53] *Id*. at 1225.

[54] *Id*. at 1223.

[55] *See* Johnny Parker, *The Wacky World of Collision and Comprehensive Coverages: Intentional Injury and Illegal Activity Exclusions*, 79 NEB. L. REV. 75, 101–06 (2000) (stating that ambiguity can arise from inconsistent policy provisions, policy organizations, or ambiguous language).

[56] Chacon v. Am. Family Mut. Ins. Co., 788 P.2d 748, 752 (Colo. Sup. Ct. 1990).

language of the severability clause creates a reasonable expectation that each insured will be separately covered, while the exclusion purports to preclude coverage for all as a result of the excluded act of one. This approach gives meaning and effect to both the severability clause and the exclusion because the culpable insured is excluded from coverage while the innocent co-insured's right to a defense and indemnification is determined separately.

This interpretive model views an exclusion and a severability clause as competing provisions. Where such is the case, the exclusion and the severability clause should be construed to require that the exclusion be applied only against culpable insureds for whom coverage is sought.[57] In other words, the clear language of a severability clause dictates that "coverage as to each insured must be determined separately based on the facts applicable to each such insured."[58]

Under this approach, because a severability clause renders a policy exclusion ambiguous,[59] the term used in the exclusion does not alter this consequence. As observed in *Brumley v. Lee*:

> The words "an" and "any" are inherently indefinite and ambiguous. The two words can and often do have the same meaning. The Random House Dictionary of the English Language 68 (1973) gives many definitions for the word "any." The first definition listed is "one, a, an, or some." Correspondingly, the Random House Dictionary includes the word "any" among its definitions for the word "a" or "an." Hence, the words may have the same meaning. Thus, the word "any" is not materially different from the word "a" or "an," and, contrary to the district court's ruling, Safeco's use of "any" instead of "an" in its policy does not eliminate the ambiguity created by the policy's severability clause.[60]

According to this interpretive model, this rule applies without regard to the type of policy, exclusion or language used therein.[61]

A severability clause, therefore, requires that the policy exclusions be interpreted with respect to the facts and circumstances specific to the

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[57] *See, e.g.*, Brumley v. Lee, 963 P.2d 1224, 1227 (Kan. 1998); Am. Nat'l Fire Ins. Co. v. Estate of Fournelle, 472 N.W.2d 292, 294 (Minn. 1991).

[58] Rose Constr. Co. Inc. v. Gravatt, 642 P.2d 569, 571 (Kan. 1982).

[59] *Brumley*, 963 P.2d at 1228.

[60] *Id.* at 1227–28.

[61] *See, e.g.*, *Rose Constr. Co.*, 642 P.2d 569 (noting that a severability clause modified an exclusion in an automobile policy using the term "an insured").

individual insured seeking coverage.[62] For example, in *American National Fire Insurance Co. v. Fournelle*, the Court entertained the issue of whether a household exclusion in a homeowners' insurance policy containing a severability clause excluded coverage where the named insured killed his two children.[63]

In *Fournelle*, Robert Fournelle and his wife, Joanne Fournelle, separated on January 16, 1985. Robert left the marital residence, while Joanne Fournelle remained in the house with the couple's two sons. After filing for divorce on January 25, 1985, she received temporary custody of the children and temporary possession of the house. Thereafter, Robert lived separate and apart from Joanne and the children.

On March 3, 1985, Robert arrived at the marital residence to visit his sons. He shot and killed the boys, vandalized the house, and then committed suicide. Joanne filed a wrongful death lawsuit against Robert's estate. The estate tendered the defense of the suit to American National pursuant to the Fournelles' homeowners' policy on the marital residence.

The American National homeowners' policy listed both Robert and Joanne as named insureds. The deceased children were not named insureds. The policy's household exclusion provided that coverage "does not apply to: f. bodily injury to you and any insured within the meaning of part a. or b. of Definition 3."[64] Throughout the policy the terms "you" and "your" referred to the named insureds – here, Robert and Joanne. Definition 3, parts a. and b. stated that: "3. 'insured' means you and the following residents of your household: a. your relatives; b. any other person under the age of 21 who is in the care of any person named above."[65] The policy also contained a severability clause.

American National argued that the severability clause was immaterial because the exclusion, by its expressed language, applied to "any insured." Therefore, since the children resided with Joanne – an insured – at the time of their death, they qualified as insureds under the policy as "person[s] under the age of 21 . . . in the care of [a named insured]." The estate countered that the severability clause required that the exclusion be read solely in reference to Robert because he was the only

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[62] *Compare* Secura Supreme Ins. Co. v. M.S.M., 755 N.W.2d 320, 324–25 (Minn. Ct. App. 2008) (holding that a juvenile's attack on a neighbor fell within the meaning of "criminal acts" as used in the policy exclusion regardless of the juvenile's intent), *with* Slavens v. Am. Fire & Cas. Co., No. C7-00-1070, 2001 Minn. App. LEXIS 94, at *5 (Minn. Ct. App. Jan. 30, 2001) (finding that an the intent of the policy was "to exclude coverage when someone who qualifies as 'an insured' under the policy commits an act of sexual molestation – regardless of whether that person is involved in the day care business").

[63] 472 N.W.2d 292, 293 (Minn. 1991).

[64] *Id.*

[65] *Id.*

insured seeking coverage under the policy.

According to the Court, American National's position was inconsistent with both the policy language and the doctrine of severability. Finding the policy's language ambiguous,[66] the Court observed that:

> Severability is a widely recognized doctrine that acknowledges the separate and distinct obligations the insurer undertakes to the various insureds, named and unnamed. The intent of a severability clause is to provide each insured with separate coverage, as if each were separately insured with a distinct policy, subject to the liability limits of the policy. Thus, severability demands that policy exclusions be construed only with reference to the particular insured seeking coverage.[67]

The Court surmised that the insurer must have inserted the severability clause in the policy for some purpose. Furthermore, a reasonable interpretation of the words "this insurance applies separately to each insured" leads to but one conclusion: that each insured must be treated as if he or she was insured separately, applying exclusions individually as to the insured for whom coverage is sought.[68] "There would be no point to a severability clause if it did not provide separately to each named insured."[69] Any other conclusion would render the severability clause meaningless.[70]

This methodology was also employed by the court in *Hilmer v. White.*[71] In *Hilmer*, Benjamin White, then seventeen-years-old, pled guilty to the attempted murder of Casey Hilmer. Benjamin had grabbed the thirteen-year-old Casey while she was jogging, dragged her into the woods, and stabbed her repeatedly in the side and neck.

Casey and her parents sued Benjamin as well as his parents, Lance and Diane White. In the civil suit, the Hilmers claimed that Lance and Diane had been negligent in that they failed to properly supervise their son and entrusted him with a dangerous instrument. The jury returned a verdict for compensatory damages in the amount of $6.5 million. The jury further determined that Lance and Diane were responsible for seventy percent of that amount.

At the time of the attack, the Whites had two homeowners'

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[66] *Id.* at 294.
[67] *Id.* (internal citations omitted).
[68] *Id.* at 294.
[69] *Id.*
[70] *Id.*
[71] No. C-070074, 2007 Ohio App. LEXIS 6288 (Ohio Ct. App. Dec. 28, 2007).

insurance policies and two umbrella policies. One of the homeowners' policies was issued by defendant – appellee Federal Insurance Company ("Federal"). One of the umbrella policies was issued by defendant – appellee Pacific Indemnity Company ("Pacific"). The remaining policies were issued by plaintiff – appellant Safeco Insurance Company ("Safeco").

Shortly after the Hilmers filed their lawsuit, Safeco filed a declaratory judgment action claiming that it owed no duty to defend or indemnify the Whites. Safeco also requested that the trial court determine the priority of coverage between the two policies that it had issued and the two issued by Federal and Pacific. The trial court concluded that the intentional tort exclusions in the Safeco policies were ambiguous because of the severability clause present in each policy. The court also held that Safeco owed coverage on a pro-rata basis with the other two insurance companies. Safeco appealed.

Lance and Diane White were named insureds in the Safeco homeowners' policy. The term "insured" also included relatives who resided in the household. The policy excluded coverage for bodily injury "which is expected or intended by an insured or which is the reasonably foreseeable result of an act or omission intended by an insured."[72] Bodily injury "arising out of an illegal act committed by or at the direction of an insured" was also excluded.[73]

Safeco's umbrella policy named Lance White as an insured. As in the homeowners' policy, the term "insured" included any member of the household.[74] It excluded from coverage "any injury caused by a violation of penal law or ordinance committed by or with the knowledge or consent of any insured"[75] as well as "any act or damage which is expected or intended by any insured, or which is the foreseeable result of an act or omission intended by any insured . . . ."[76] Both the homeowners' policy and the umbrella policy contained a severability provision stating that "[t]his insurance applies separately to each insured . . . ."[77] The appellate court affirmed the trial court and concluded that Safeco's use of the terms "an insured" and "any insured" in its homeowners' and umbrella policies, respectively, caused the exclusions to be ambiguous when read in conjunction with the severability clause found in each.[78]

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[72] *Id.* at *8 (internal quotation marks omitted).

[73] *Id.*

[74] *Id.*

[75] *Id.*

[76] *Id.* at *8–9.

[77] *Id.* at *9.

[78] *Id*. at *11–12; *see also* Ill. Union Ins. Co. v. Shefchuk, 108 Fed. App'x 294 (6th Cir. 2002). The court's conclusion in *Hilmer* has not, however, been consistently followed by other lower courts in Ohio. *See* United Ohio Ins. Co. v. Metzger, No. 12-98-1, 1999 Ohio App. LEXIS 920 (Ohio Ct. App. Feb. 8, 1999). Interestingly, the Ohio Supreme Court has refused to resolve the conflict that exists

This interpretive method is predicated on the maxims that an insurance policy must be read as a whole and, that ambiguity in an insurance contract can arise from inconsistent policy provisions[79] as was the case in *Fournelle* and *Hilmer*, or from ambiguous language as in *Brumley*. As demonstrated by *Hilmer,* the determination that an ambiguity exists as a consequence of inconsistent policy provisions requires little more than an examination of the entire policy and application of the rule of *contra proferentem.* That is, ambiguity will be construed against the drafter and in favor of coverage.

C. METHODOLOGY NO. 3

This interpretive method is the most complex and perplexing of any used to resolve severability clause disputes. While the focus of the inquiry remains the intention of the parties, courts using this approach do not treat "an" or "any" as synonymous. Consequently, these courts reach a different result regarding the effect of a severability clause depending on whether an exclusion refers to the conduct of "an" or "any" insured.[80]

1. Methodology No. 3a

In light of a policy's severability clause, exclusions referring to the conduct of "an" insured have been distinguished from those using the phrase "any" insured and construed to apply separately to each insured such that one insured's excluded activity does not preclude coverage for other insureds who did not participate in the excluded activity.[81] For example, in *United Services Automotive Association v. DeValencia*,[82] an Arizona appellate court found itself confronted with determining a

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among the state appellate courts regarding the issue of whether a severability clause renders an exclusion using the term "an insured" ambiguous. *See* Safeco Ins. Co. of Am. v. White, 913 N.E.2d 426 (Ohio 2009).

[79] *See* Parker, *supra* note 55.

[80] *Compare* Nw. Nat'l Ins. Co. v. Nemetz, 400 N.W.2d 33, 38 (Wis. Ct. App. 1986) (concluding that the "contract [was] ambiguous because the severability clause create[d] a reasonable expectation that each insured's interests [were] separately covered, while the exclusion clause attempt[ed] to exclude coverage for both cause by the act of [an insured]), *with* Taryn E.F. v. Joshua M.C., 505 N.W.2d 418, 422 (Wis. Ct. App. 1993) (finding that "the term 'any insured' unambiguously precludes coverage to all persons covered by the policy if any one of them engages in excludable conduct"), *and* Nationwide Mut. v. Mazur, CV 980489231S, 1999 Conn. Super. LEXIS 1533 (Conn. Super. Ct. June 3, 1999) (finding that a "policy's specific use of the words, 'each' and 'an,' as opposed to the determiner 'any,' demonstrates an intent to provide coverage to the insureds separately").

[81] *See, e.g.,* Litz v. State Farm Fire & Cas. Co., 695 A.2d 566 (Md. 1997).

[82] 949 P.2d 525 (Ariz. Ct. App. 1997).

severability clause's effect on an exclusion from the perspective of a novel factual situation. Therein, Dennis and Debra Gerow provided day care in their home to three minor children of the appellants, the DeValencias. After discovering that their children had been molested by the Gerow's fourteen-year-old son CG, the DeValencias asserted negligent supervision and breach of contract claims against the Gerows.

The Gerows' homeowners' insurer – USAA – filed an action for declaratory judgment in response to the DeValencias' lawsuit, asserting that its policy did not cover their claim. The trial court granted USAA's motion for summary judgment, concluding that there was no coverage under the policy because the business pursuit exclusion precluded liability coverage for acts and omissions "arising out of or in connection with a business engaged in by an insured."[83] The parties agreed that this exclusion was applicable to CG's parents – the Gerows. The DeValencias, however, argued that it was not applicable to CG because of the policy's severability clause, which provided "[t]his insurance applies separately to each insured. This condition will not increase our limit of liability for any one occurrence."[84]

The court concluded that because the exclusion referred to the acts of "an insured," applicability of the exclusion should be determined separately as to each insured. Thus, "to bring CG's acts within the business pursuit exclusion, USAA was obliged to show that he was individually engaged in a business pursuit when he committed the alleged acts."[85]

The court's reasoning and holding in *DeValencia* were subsequently clarified in *Am. Family Mut. Ins. Co. v. White.*[86] Therein, Travis Wilde hit Bryan White in the head with a metal pipe. Travis pled guilty to aggravated assault. White later sued Travis and his parents ("the Wildes"), who filed a claim with their insurance carrier, American Family. American Family filed a declaratory judgment action asserting that all the claims by all insureds were precluded under the "violation of law" exclusion contained in the Wildes' homeowners' policy: "Violation of Law. We will not cover bodily injury or property damage arising out of . . . violation of any criminal law for which any insured is convicted . . . ."[87]

According to the Wildes, because American Family's policy contained a severability of insurance clause identical to that in *DeValencia*, *DeValencia* was controlling, and the applicability of the exclusion had to be determined separately as to each insured. Therefore, because only

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[83] *Id.* at 527 (internal quotation marks omitted).

[84] *Id.*

[85] *Id.*

[86] 65 P.3d 449 (Ariz. Ct. App. 2003).

[87] *Id.* at 452. The policy also contained an "Intentional Injury" exclusion, which like the violation of law exclusion, used the term "any insured." *Id.* at 453 n.2.

Travis was convicted of violating a criminal law, the claims against them remained covered under the policy.[88]

The court rejected this argument and distinguished the exclusionary clause in *DeValencia* from that in the American Family policy purchased by the Wildes. "The exclusionary clause in *DeValencia* applied to 'acts or omissions 'arising out of or in connection with a business engaged in by *an* insured.'"[89] The exclusion at issue in the case at hand applied to "violation of any criminal law for which *any* insured is convicted."[90] While the parties agreed that "any" meant no more than "an," the court, which viewed the matter as a question of law, drew its own conclusion. Deferring to the majority view, it concluded that the phrase "any insured" in an applicable exclusion operates as a bar to coverage for any claim of any insured, even if the policy contains a severability clause.[91]

DeValencia and *White* indirectly or implicitly held that the terms "an insured" or "any insured" when used in an exclusion are neither synonymous nor affected similarly by the presence of a severability clause in the policy. However, in *Nationwide Mut. v. Mazur,*[92] these questions were addressed head on. In *Mazur*, Michael Mazur, a minor, lured Andrew Christmas to a remote area where he assaulted and struck him with such force as to render Andrew unconscious. Michael then proceeded to punch and kick Andrew in the head while he lay helpless and unconscious on the ground. Andrew and his father filed suit against Michael and his mother—Judy Mazur – seeking to recover damages for injuries incurred by Andrew as a result of the assault.

Judy filed a claim under her homeowners' policy provided by Nationwide Mutual ("Nationwide"). Nationwide denied the claim, asserting that it had no duty to defend or indemnify either Michael or Judy because Michael's acts were intentional and expressly excluded in the policy. The relevant exclusion provided in part: "Coverage E Personal Liability . . . [does] not apply to bodily injury . . . . a. caused intentionally by or at the direction of an insured, including willful acts the result of which the insured knows or ought to know will follow from the insured's conduct."[93] Judy contended that because the policy included a severability clause, she, as a separate insured under the policy, was entitled to coverage even if coverage was excluded for Michael.

The court agreed. It construed the inclusion of the severability

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[88] *Id.* at 456.

[89] *Id.* (quoting United Servs. Auto. Ass'n v. DeValencia, 949 P.2d 525, 527 (Ariz. Ct. App. 1997)).

[90] *Id.*

[91] *Id.*

[92] CV 980489231S, 1999 Conn. Super. LEXIS 1533 (Conn. Super. Ct. June 3, 1999).

[93] *Id.* at *25–26.

provision in the policy as recognition on the part of Nationwide that it owed Judy a distinct and separate coverage obligation aside and apart from any obligations it owed Michael. Consequently, whether Michael's conduct was excluded under the policy had no effect on Judy's entitlement to coverage.

Nationwide also argued that the term "an insured" was synonymous with "any insured" in the intentional acts exclusion.[94] The court rejected this assertion and concluded, that the policy's use of the term "each" in the severability clause and "an" in the exclusion demonstrated an intent to provide coverage to the insureds separately. Where the terms "an" or "any" are viewed as distinct, the latter term is often construed to unambiguously deny coverage to all insureds as the result of excluded conduct by any of the persons insured by the policy.[95] The presence of a severability clause generally does not change this result.

In this method, the intent and purpose of the severability clause, which is to limit the scope of the exclusion to the insured seeking coverage, is construed in light of the language – "an insured" – as used in an exclusion. Where the phrase "an insured" is construed as being modified by a severability clause, a narrow construction of the exclusion is implied from the presence of the severability clause in the policy. This means that coverage consists of "what . . . the insured expected to receive and what the insurer agreed to provide, as disclosed by the provisions of the policy . . . ."[96] This approach does not assume that an exclusion is *per se* ambiguous merely because the policy contains a severability clause.[97] Rather, the exclusion is applied to each insured individually for purposes of determining whether there is coverage. The end result is that both the severability clause and the exclusion are given effect.[98] The opposite result occurs where the phrase "any insured" is used.

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[94] *Id.* at *27.

[95] *See* Taryn E.F. v. Joshua M.C., 505 N.W.2d 418, 422 (Wis. Ct. App. 1993); White, 65 P.3d 449; Chacon v. Am. Fam. Mut. Ins. Co., 788 P.2d 748 (Colo. 1990); Am. Fam. Mut. Ins. Co. v. Corrigan, 697 N.W.2d 108 (Iowa 2005); Am. Fam. Mut. Ins. Co. v. Copeland–Williams, 941 S.W.2d 625 (Mo. Ct. App. 1997); Oaks v. Dupuy, 653 So. 2d 165 (La. Ct. App. 1995); *but see,* Am. Fam. Mut. Ins. Co. v. Bower, 752 F. Supp. 2d 957, 971 (N.D. Ind. 2010) (explaining a severability clause renders an exclusion referring to the conduct of any insured ambiguous); W. Am. Ins. Co. v. AV&S, 145 F.3d 1224 (10th Cir. 1998) (explaining a severability clause renders an exclusion referring to the conduct of any insured ambiguous); Worcester Mut. Ins. Co. v. Marnell, 496 N.E.2d 158 (Mass. 1986); Premier Ins. Co. v. Adams, 632 So. 2d 1054 (Fla. Dist. Ct. App. 1994) (noting the term "any insured" modified by the presence of a severability clause).

[96] *See* Covenant Ins. Co. v. Sloat, No. 385786, 2003 Conn. Super. LEXIS 1557, at *20 (Conn. Super. Ct. May 23, 2003).

[97] *See Mazur,* 1999 Conn. Super. LEXIS 1533, at *26–27.

[98] *Sloat,* 2003 Conn. Super. LEXIS 1557, at *34–37.

2. Methodology No. 3b

This methodology is a variant of the one just discussed. It differs only in its reliance on the principle of ambiguity to achieve coverage. It is discussed separately for two reasons. First, only a couple of state Supreme Courts have used the principle of ambiguity to determine the impact of a severability clause on an exclusion referring to the conduct of "an insured" distinct from "any insured." Second, it further demonstrates the general negative treatment that the phrase "an insured," when divorced from "any insured," has received throughout severability of interests clause interpretation.[99] The California Supreme Court's *Minkler v. Safeco Ins. Co.* [100] decision is the most prominent example of this methodology. It illustrates both propositions.

In *Minkler*, the California Supreme Court agreed to answer a question of California insurance law directed to it by the United States Court of Appeals for the Ninth Circuit. The question asked was "[w]here a contract of liability insurance covering multiple insureds contains a severability-of-interest clause . . . , does an exclusion barring coverage for injuries arising out of the intentional acts of 'an insured' bar coverage for claims that one insured negligently failed to prevent the intentional acts of another insured?"[101] *Minkler* involved a lawsuit filed by Scott Minkler against David Schwartz and his mother Betty Schwartz. Scott alleged that David, an adult, had sexually molested him when he was a minor. Some of these acts allegedly occurred in Betty's home and as a result of her negligent supervision.

Betty was the named insured under a series of policies issued by Safeco Insurance Company ("Safeco"). David was an additional insured in each policy. The policies provided liability coverage to an insured for personal injury or property damages arising out of a covered occurrence. They excluded from coverage any injury that was "expected or intended by an insured or which [was] the foreseeable result of an act or omission intended by an insured . . . ."[102] The policy also contained a severability of interest provision which provided that "[t]his insurance applies separately to each insured."[103] The ultimate question before the Court was whether Betty "was barred from coverage only if her *own* conduct in relation to David's molestation of Scott fell within the policies' exclusion for

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[99] *See* Wilson v. State Farm Mut. Auto. Ins. Co., 540 So. 2d 749 (Ala. 1989)(illustrating how exclusion is ambiguous even in the absence of a severability clause).

[100] 232 P.3d 612 (Cal. 2010).

[101] *Id.* at 616.

[102] *Id.* at 615.

[103] *Id.*

intentional acts."[104]

The *Minkler* Court expressly noted the split of authority surrounding the issue of the impact of a severability clause on a policy exclusion referring to the acts of "an" or "any" insured.[105] It also recognized that California law, in the absence of contrary evidence, viewed exclusions from coverage described in reference to the acts of "an" or "any," as opposed to "the," collectively, so that if one insured committed an excluded act, all insureds were barred from coverage.[106] Nevertheless, the Court concluded that, "an exclusion of coverage for the intentional acts of 'an insured,' read in conjunction with a severability or 'separate insurance' clause like the one at issue . . . creates an ambiguity which must be construed in favor of coverage that a lay policyholder would reasonably expect."[107]

Minkler has several noteworthy aspects. First, the Court's reasoning – which focused on the language of both the severability clause and the exclusion, in light of the reasonable expectation of the insured – is concise and consistent with the rules of insurance contract interpretation. Second, the holding of the court is supported in part by the general, rather than specific, nature of the exclusion. In other words, the use of the term 'an' is insignificant and does not cause an exclusion to be specific in nature. Third, the Court cautioned that its reasoning and holding under the specific circumstances of the case did not mean that a severability clause necessarily affects all exclusions framed in terms of "an" or "any" insured.[108] This cautionary note manifests judicial awareness of the fact-sensitive nature of insurance policy interpretation. In this context, it reflects sensitivity to situations where application of a severability clause would render an absurd result such as converting the policy purchased into a type of policy which was neither negotiated nor paid for.[109]

Courts employing Methodology 3a and 3b, respectively are exercising a policy choice in favor of coverage in limited situations. That choice is reflected in the restricted application of the functional theory of contract interpretation to this methodology. The problem, however, is that the functional approach is neither fully nor consistently applied. For example, in the context of the term "an insured," the philosophy of the reasonable expectation of a lay insured has been fully integrated. However,

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[104] *Id.* at 614.
[105] *Id.*
[106] *Id.* at 617.
[107] *Id.* at 614.
[108] *Id.* at 621–22 n.5.
[109] *See, e.g.,* BP Am. Inc. v. State Auto Prop. & Cas. Ins. Co., 148 P.3d 832 (Okla. 2005); Transit Cas. Co. v. Hartman's, Inc., 239 S.E.2d 894 (Va. 1978); Shelter Mut. Ins. Co. v. Haller, 793 S.W.2d 391 (Mo. App. 1990).

when the exclusion is couched as "any insured," the outcome reflects the functional theory of contract interpretation.

III. RECONCILING THE INTERPRETIVE METHODOLOGIES

While the ultimate legal conclusion reached in a particular case is frequently dictated by individual circumstances, the legal reasoning used by the court is often less transparent. Nevertheless, there is a method to the madness. The interpretive methodologies used to resolve severability disputes indicate that courts are applying principles of contract interpretation in a manner that reflects two competing approaches: (1) the "traditional" or "formalist" approach; (2) the "functional" or "reasonable expectation" approach.[110] These approaches differ in that the "traditional"

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[110] *See* Collins v. Farmers Ins. Co., 822 P.2d 1146, 1159 (Or. 1991) (Unis, J., dissenting). Justice Unis, dissenting, explained the similarities and distinctions between these interpretive approaches:

> Under the "traditional" or "formalist" approach, the court looks to the "four corners" of the insurance policy and interprets it by applying rules applicable to all contracts in general. The insured is held to have read and to have understood the clear language of the policy. Extrinsic evidence relating to the insurance contract may be examined for the purpose of determining the parties' intention to an objective analysis of the "four corners" of the contract. . . . The rationale behind the "formalist" approach is that contracts of insurance rest upon and are controlled by the same principles of law that apply to other contracts, and the parties to an insurance contract may provide such provisions as they deem proper as long as the contract does not contravene law or public policy (citations omitted). . . . The competing approach to insurance contract interpretation—the "functional" or "reasonable expectation" approach – is that the policyholder's reasonable expectations to coverage under the insurance policy should be honored even though those expectations vary from the policy provisions. . . . The "functional" or "reasonable expectation" approach is supported by the notion that insurance contracts are not ordinary contracts negotiated by parties with roughly equal bargaining strength. Rather, they are largely contracts of adhesion, where the insurance company, in preparing a standardized printed form, has the superior bargaining position, and the insured has to accept such a policy on a "take-it-or-leave-it" basis if the insured wants any form of insurance protection. . . . Restatement (Second) of Contracts, § 211 (1981), "[r]epudiates the 'four-corners' ['traditional' or 'formalist'] approach to contract interpretation in the standardized agreement setting and in effect approves a doctrine of 'reasonable expectations.'" . . . A growing number of courts

theory is logically based and precedent-oriented, whereas the "functional" theory is sociologically-based and result-oriented.[111]

According to the "traditional" or "formalist" approach, correct legal decisions are determined by pre-existing legal precedent. Courts reach their decisions by logical deduction which results from applying the facts of a case to a set of pre-existing legal rules. The "traditional" approach is premised entirely on the theory that the law is a science consisting of socially-neutral, logical principles and rules.[112] Pursuant to the "traditional" or "formalist" approach, a severability clause ordinarily will not negate an exclusion unless: (1) the policy is ambiguous; (2) the exclusion is masked by technical or obscure language; or (3) the exclusion is hidden in the policy provisions.[113]

The "functional" or "reasonable expectation" approach posits "that the paramount concern of the law should not be logical consistency . . . but socially desirable consequences."[114] The "functional" approach looks into the future and considers "[w]hat substantive goals, derived from popular wants and interests, are relevant? What rules or other precepts are required to further them?"[115] Thus, the "functional" approach supports a finding of coverage "if (1) the insurer knew or should have known of the insured's expectation; (2) the insurer created or helped to create those expectations; or (3) the insured's expectations are objectively reasonable in light of the

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> use the "functional" approach to protect the "reasonable expectations" of the insured policyholder from possible denial of coverage that might result under the "traditional" or "formalist" contractual analysis of an insurance policy.

Id. at 1159–61 (citations omitted).

[111] Peter Nash Swisher, *Judicial Rationales in Insurance Law: Dusting Off the Formal for the Function*, 52 OHIO ST. L.J. 1037, 1042 (1991).

[112] *Id.* at 1040–41. The formalist approach has been described as:

> It is not the duty of our courts to be leaders in reform … The judge is always confined within the narrow limits of reasonable interpretation. It is not his function or within his power to enlarge or improve the law [since that is the function of the legislature]. His duty is to maintain it, to enforce it, whether it is good or bad, wise or foolish . . . .

id. at 1042 (quoting Elihu Root, *The Importance of an Independent Judicary*, 72 THE INDEPENDENT 704 (1912)).

[113] Johnny Parker, *The Wacky World of Collision and Comprehensive Coverages: Intentional Injury and Illegal Activity Exclusion*, 79 NEB. L. REV. 75, 110 (2000).

[114] Swisher, *supra* note 105, at 1043.

[115] *Id.*

circumstances and facts of the case."[116] "There is no disagreement between the "formalist" and the "functional" approaches whenever the insurance policy is ambiguous or susceptible to two or more reasonable interpretations."[117]

The traditional or formalist[118] articulates the objective of contract interpretation as ascertaining the intention of the parties and, thereafter, inquires as to whether any rational support favoring application of the exclusion exists. Such support is often gleaned from the language of the exclusion to the extent that it can be described as specific (as opposed to general in nature), unambiguous or imposing a joint obligation. The formalistic approach is strict in its adherence to precedents and harsh in that it favors the insurer's interpretation of the policy. This approach also reflects a paternalistic interest in protecting an industry from the consequences of its own ill-advised drafting.

The overarching principle of contract interpretation is to ascertain and give effect to the intention of the parties. While the interpretation of insurance contracts is guided by this principle, it is controlled by somewhat different standards because an insurance contract is often one of adhesion, particularly in personal lines. Adhesion contracts provide insureds with little choice beyond electing among standardized provisions offered to them on a take it or leave it basis. Furthermore, many insureds cannot view their policy language until after tendering payment.[119] Consequently, under the functional approach, insurance policies are construed to provide coverage which a layperson would reasonably expect, given a lay interpretation of the policy language.[120] This construction offsets the greater bargaining position of insurance companies and prevents the use of insurance policies as a wholesale method of controlling applicable law.[121] In contrast, the formalist approach ignores the fact that insurance contracts are contracts of adhesion, typically written to afford greater protection to the insurer.

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[116] Parker, *supra* note 107, at 111.

[117] *See Collins*, 822 P.2d at 1161 (Unis, J., dissenting).

[118] *See, e.g.*, The Ohio Cas. Ins. Co. v. Holcim (US), Inc., 744 F. Supp. 2d 1251 (S.D. Ala. 2010); Md. Cas. Co. v. Am. Fidelity & Cas. Co., 217 F. Supp. 688 (E.D. Tenn. 1963); Am. Family Mut. Ins. Co. v. White, 65 P.3d 449 (Ariz. Ct. App. 2003); BP Am., Inc. v. State Auto Prop. & Cas. Ins. Co., 148 P.3d 832 (Okla. 2005); Coop. Ins. Cos. v. Woodward, 45 A.3d 89 (Vt. 2012).

[119] *See* Daniel Schwarcz, *Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection*, 61 UCLA L. REV. (forthcoming Jan. 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2130908.

[120] Stordahl v. Gov't Emp. Ins. Co., 564 P.2d 63, 65–66 (Alaska 1977); Lee v. Interinsurance Exch., 57 Cal. Rptr. 2d 798 (Cal. Ct. App. 1986).

[121] Am. Serv. Mut. Ins. Co. v. Bottum, 371 F.2d 6, 12 (8th Cir. 1967).

The functional approach to severability clause interpretation is reflected in every interpretive methodology which holds that a severability of interests provision modifies an exclusion referring to the conduct of 'an' or 'any' insured. [122] However, the functional approach has only been fully incorporated into Methodology No. 2, thus, making it the most insurance consumer oriented. Methodology No. 2 is superior to Methodologies 3a and 3b because it recognizes that an insurance contract is one of adhesion and shifts the entire risk of loss to the drafting party by giving effect to the severability clause regardless of the language used to describe the excluded conduct. Methodologies 3a and 3b use the functional approach to shift the burden of loss to the drafting party by giving effect to the severability clause exclusively in the context of exclusions referring to the conduct of "an insured." Both 3a and 3b use the traditional theory of contract interpretation when an exclusion refers to the conduct of "any insured." Methodology No. 1 is the least favorable to insurance consumers because it relies solely on the traditional theory of contract interpretation, pursuant to which the adhesive nature of insurance contracts is insignificant.

The functional approach considers the policy as a whole and typically employs the principle of ambiguity or reasonable expectation of the insured to construe the severability clause in favor of coverage or as having severed application. The availability of clearer language and alternative provisions are relevant considerations in the context of the functional approach to insurance contract interpretation. The functional approach has become firmly entrenched in insurance law jurisprudence over the past four decades.[123]

The functional approach, unlike its "traditional" counterpart, promotes fairness in policy interpretation by avoiding the recognition of a per se rule of coverage or non-coverage. Rather, the exclusion, in light of the presence of the severability clause, is applied to each insured separately. It also promotes and encourages careful drafting. For if it is

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[122] *See* Am. Fam. Mut. Ins. Co. v. Corrigan, 697 N.W.2d 108 (Iowa 2005); Chacon v. Am. Fam. Mut. Ins. Co., 788 P.2d 748 (Colo. 1990); Am. Family Mut. Ins. Co. v. White, 65 P.3d 449 (Ariz. Ct. App. 2003); Am. Fam. Mut. Ins. Co. v. Copeland Williams, 941 S.W.2d 625 (Mo. Ct. App. 1997); Taryn E.F. v. Joshua M.C., 505 N.W.2d 418 (Wis. Ct. App. 1993). *But see* West Am. Ins. Co. v. AV&S, 145 F.3d 1224 (10th Cir. 1998) (finding severability clause renders an exclusion referring to the conduct of any insured ambiguous); Am. Fam. Mut. Ins. Co. v. Bower, II, 752 F. Supp. 2d 957 (N.D. Ind. 2010) (finding severability clause makes an exclusion referring to the actions of any insured ambiguous); Worcester Mut. Ins. Co. v. Marnell, 496 N.E.2d 158 (Mass. 1986).

[123] The formal articulation of the doctrine is generally traced to Judge, then Professor, Robert Keeton's seminal article, Robert Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARVARD L. REV. 961 (1970). 2 ERIC MILLS HOLMES & MARK RHODES, HOLMES' APPLEMAN ON INSURANCE, 2D 416 (1996).

asked, "why do insurance companies include severability clauses in insurance contracts?," the "functional" answer is that a severability clause objectively conveys the impression of coverage. It appears to be the virtually unanimous opinion of the legal scholars writing on the subject that the purpose of the addition of the severability clause was to provide coverage.[124] Otherwise, the clause is unnecessary.

The problems associated with severability clause interpretation could easily be resolved by employing language which clearly alerts insureds to the absence of coverage. The functional approach imposes such an obligation on insurers. Where insurers fulfill this obligation, their interpretation of the exclusion should be adopted.

For example, in *Northwest G. F. Mut. Ins. Co. v. Norgard,*[125] the insurer used language specifically designed to avoid a severability clause dispute. In *Norgard,* Ray and Jean Norgard purchased a homeowners' policy from Northwest G. F. Mut. Insurance Company ("Northwest"). Jean operated a home day care business for which she purchased additional insurance coverage from Northwest. Under the day care endorsement, Northwest provided coverage for "bodily injury and property damage arising out of home day care services regularly provided by an insured and for which an insured receives monetary or other compensation."[126] It excluded coverage for "bodily injury or property damage arising out of sexual molestation, corporal punishment or physical or mental abuse inflicted upon any person by or at the direction of an insured, an insured's employee or any other person involved in any capacity in the day care enterprise . . . ."[127] Ray was the named insured and all relatives residing in the Norgard household were also insured under the homeowners' policy.

Ray Norgard was accused and convicted of engaging in sexual contact with L.A.A., the Andersons' four-year-old daughter, while the child was under Jean's supervision at day care. The Andersons brought a civil action against both Ray and Jean, accusing the latter of negligence in the supervision and care of the child. The Norgards tendered the claim to Northwest.

Northwest filed a declaratory judgment action seeking to establish that it was not obligated to defend or indemnify either Ray or Jean because the injuries arose out of Ray's sexual molestation, which was specifically excluded from coverage. While the parties agreed that Ray was disqualified from coverage under the sexual molestation exclusion, they disagreed as to whether Jean was entitled to coverage. The Norgards argued that she was because of the severability provision, which provided

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[124] Shelby Mut. Ins. Co. v. Schuitema, 183 So. 2d 571, 573 (Fla. Dist. Ct. 1966).

[125] 518 N.W.2d 179 (N.D. 1994).

[126] *Id.* at 180.

[127] *Id.*

that "this insurance applies separately to each insured . . . ."[128]

In ruling on a motion for summary judgment, the district court judge found that the severability clause and the sexual molestation exclusion, when read together, were ambiguous, thus warranting construction in favor of coverage. Northwest appealed.

On appeal, the Court reversed, holding that the severability clause precluded coverage to Jean. The Court based its conclusion on the unique language of the exclusion, which pertained to the conduct of not only "an insured" but also "an insured's employee or any other person involved in any capacity in the day care enterprise . . . ." This language manifested the clear intent of the parties to preclude coverage when any person connected with the operation of the day care engaged in sexual molestation of one of the children. The language clearly and specifically provided that these risks were outside the scope of the policy.[129]

Where the language of the exclusion is particularly tailored to except from coverage specific acts of specific individuals, it should prevail over a more general provision such as the severability clause. Similarly, the absence of any reference to a specific actor – "an insured" or "any insured" – in an exclusion demonstrates that the parties intended to base the exclusion on the nature of the act, rather than on the identity of the actor.[130] In either instance, the severability clause is subordinate to the exclusion.[131]

Severability disputes could also be avoided by replacing the severability clause with a joint obligation clause in the policy. The latter provides: The terms of this policy impose joint obligations on persons defined as an insured person. This means that responsibilities, acts and failures to act of a person defined as an insured person will be binding upon another person defined as an insured person.

IV. CONCLUSION

The conflict that exists in the law of severability clause interpretation is primarily a consequence of misguided adherence to and use of the traditional or formalistic theory of contract interpretation. This theory has no place in modern day insurance contract interpretation. This proposition is illustrated by the court's analysis in *Maryland Casualty Company v. American Fidelity & Casualty Company.*[132] There, a federal district court was called upon to predict how the Tennessee Supreme Court

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[128] *Id.* at 181.

[129] *Id.* at 183.

[130] *See, e.g.,* Ristine v. Hartford Ins. Co. of the Midwest, 97 P.3d 1206, 1209 (Or. Ct. App. 2004).

[131] *See, e.g.,* Nw. G.F. Mut. Ins. Co. v. Norgard, 518 N.W.2d 179, 183 (N.D. 1994); Ristine v. Hartford Ins. Co., 97 P.3d 1206, 1210 (Or. Ct. App. 2004).

[132] 217 F. Supp. 688 (E.D. Tenn. 1963).

would resolve the question of whether a severability clause affected an employee exclusion contained in an automobile liability policy. The court found both the exclusion and the severability clause to be ambiguous because the language used was susceptible to two reasonable interpretations.[133] Ambiguity was also evidenced by the fact that various courts had arrived at conflicting conclusions as to the meaning of both clauses.[134]

Despite its finding of ambiguity, which should have been resolved in favor of the non-drafting party, the court proceeded to a consideration of prevailing precedents. In that context, the court, despite its express disagreement with the soundness of the conclusions reached, felt constrained to hold that any employee of "the insured" meant any employee of *any* insured. In *Maryland Cas.,* use of the traditional theory of contract interpretation resulted in a restrictive construction of the severability clause which, though acknowledged by the court to be unsound, was nevertheless condoned (possibly because the court felt constrained as a federal court sitting in diversity).

Rigid adherence to the traditional theory of contract interpretation limits the legal system's ability to deal with some of the most problematic and frequently litigated questions of insurance coverage. It unduly limits the analysis of the meaning and function of insurance contracts. For these reasons severability of interests clause interpretation remains the "only known situation where many of the courts persist in erring in *favor* of the insurance companies!"[135]

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[133] *Id.* at 691–692.

[134] *Id.* at 692.

[135] Norman E. Risjord & June M. Austin, "*Who is the 'Insured'" Revisited*, 28 INS. COUNS. J. 100, 101 (1961).