Breach of Policy Conditions and the "Severability of Interests" Doctrine

June 2000

In the event of a breach of one or more property insurance policy conditions involving one insured corporation or insured location, is the policy void as to the coverage provided for the other insureds at other insured locations?

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Property insurance policies frequently will insure many different locations and, often, many different but related corporations under the same coverage. A typical property insurance policy also will contain numerous pre- and post-loss conditions that must be satisfied to maintain coverage or secure payment following a loss. (See, e.g., *Standard Fire Policy*, lines 90–122, "Requirements in case loss occurs.")

The question then arises whether, in the event of a breach of one or more of these policy conditions involving one insured corporation or insured location, is the policy void as to the coverage provided for the other insureds' property at other insured locations?

The authors of a noted multivolume treatise point out the significance of this question.

Whether a contract of insurance is considered entire or whether its parts are severable is of great importance in determining the effect of a breach of a part of the contract. If the contract is entire, all of the insured's protection will be lost upon a breach as to any part of the risk, but if the contract is severable, only the part of the policy directly affected by or connected with the breach will be avoided.

Couch on Insurance, 3d,§ 23:1

The "severability of interests" doctrine seeks to answer the question of whether a forfeiture of coverage for one loss or on one property extends to all losses or properties insured under the same policy. In essence, this requires an analysis of whether the contract of insurance is "severable" or "indivisible." The question of indivisibility or severability of an insurance contract is not a new one. In *Commercial Ins. Co. v Spanknoble*, 52 Ill 53, 4 Am Rep 582 (1869), the court concerned itself with whether the coverage for boilers, vats, and other

equipment was severable from the coverage for a brewery following a fire loss as they amounted to separate classes of property. Similar disputes are sprinkled throughout the case law reporters.

As explained in *Appleman, Insurance Law and Practice,* Vol. 4, Chap. 118:

It has been said that where property is so situated that the risk on one item cannot be affected without affecting the risk on the other items, the policy is entire and indivisible, but where the property is so situated that the risk on each item is separate and distinct from the others, so that what affects the risk on one item does not affect the risk on the others, the policy is severable and divisible.

* * *

Where there are distinctly separate objects of insurance which are covered by the contract, such as different articles of personalty, different buildings, or buildings and their contents, the great tendency of most modern decisions is to hold such contracts separable so as to permit protection upon the bulk of the property even if the contract is void as to a certain portion thereof.

* * *

Such a policy may be valid as to one class of subject matter and void as to another, and the fact that the policy is void as to one item does not render it completely unenforceable. And this has been held even though the contract, by its terms, made the entire policy void upon the breach of any condition.

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Thus, a policy which is void as to buildings, by virtue of some statute, may be valid as to the personalty, the illegal provisions being distinct and capable of separation, particularly where there is no express provision in the act to render the whole contract void. Conversely, although it may be void as to the personalty, it may be valid as to the realty.

Appleman, Vol. 4, pp. 394–403

Determining whether a policy is divisible requires a review of numerous factors and, ultimately, is a question of the intent of the parties as determined from a review of the terms of the contract and general rules of construction. Factors considered relevant to discerning the intent

of the parties include (1) the entirety or interdependency of the risk covered by the policy; (2) whether the premiums and values of property insured have been divided or separately stated; (3) any other special language of the policy (*Couch, supra*).

To the extent a majority and minority rule emerges, the principle difference is the significance paid to separately stated valuations and premiums. The majority would hold the contract severable and the minority would view the value limitation as merely a limitation on the insurer's liability in the event of loss (*Appleman*, § 2374).

The result is different in the event of a willful fraud. Even in the absence of a statute rendering a policy void, the rule of divisibility usually will not apply in such event and a fraud by an insured will defeat coverage under the policy for loss to items to which the fraud does not apply. Thus, coverage under a policy that otherwise would be severable in the event of a breach of another policy condition will be forfeited if the insurer is defrauded. (This issue is distinct from the question of whether a breach of conditions as to a single item of insured property following a single loss should be imputed to all insureds, thus denying payment to any insured for that loss. This is typically called the "innocent coinsured doctrine" and is beyond the scope of this article. See e.g., *AutoOwners Ins. Co. v Eddinger,*366 S2d 123 (Fla 2d DCA 1979).)

Critical to the forfeiture as a result of fraud analysis is the question of by whom the fraud is committed. To void coverage, the concealment, misrepresentation, or fraud must be committed by "an insured," which includes an officer or director of the insured corporation. Traditionally, an employee's acts done within the scope of his employment may be imputed to the corporation. (See *Upjohn Company v New Hampshire Insurance Company*, 476 NW2d 392 (Mich 1991) (where an Upjohn employee's knowledge that a chemical tank was leaking was imputed to Upjohn); *K & T Enterprises, Inc., v Zurich Ins. Co.*, 97 F3d 171 (6th Cir 1996).)

However, fraudulent acts of employees are usually outside the scope of employment and cannot bind the company. (See *Owl & Turtle, Inc., v Travelers Indemnity Co.*, 554 F2d 196 (5th Cir 1977) (where an act of arson by an individual with no managerial authority was not imputed to corporate insured because its management had no knowledge of, or did not consent to, the criminal act).)

In the event of a loss, the insured certainly should strive to comply with all stated policy conditions. But while the failure to do so may render coverage for that particular loss forfeited,

it will be a rare instance when the entire coverage for unrelated property is forfeited, absent a fraudulent act or omission by an officer or director of the insured.