

**OUTSIDE COUNSEL**

BY THOMAS E. CHASE

*All-Risks Insurance, Exceptions to Exclusions: Burden of Proof?*

In any close case the assignment of the burden of proof may be decisive. This column discusses the burden-shifting that occurs in litigation of "all-risks" property insurance policies and the undecided question of which party has the burden of proof regarding "exceptions to exclusions" from coverage.

New York law is not clear whether the policyholder or the insurance company has the burden of proof on a broad category of claims arising under "all risk" property insurance policies.

There are conflicting decisions concerning the burden of proof for claims involving "exceptions to exclusions."

This is an important issue because all-risks policies are a common form of policy and "exceptions to exclusions" cover many categories of loss. Further, most insurers use standardized form policies, so this issue comes up nationwide.

A few other states have addressed this issue, but New York law is unclear and awareness of the issue is extremely important for attorneys representing policy holders in disputes with their insurers.

**'All-Risks' Property Insurance**

"All-risks" property insurance covers all damage, or "loss," to property except losses that are specifically excluded by the policy. By contrast, "named-perils" insurance covers losses specifically enumerated by the policy, and no others. All-risks insurance provides better coverage because there is a presumption in favor of coverage unless the insurer establishes that the loss is specifically excluded by the policy.

Importantly, it will rarely be obvious to the attorney or judge inexperienced in insurance matters that a policy is an all-risks policy entitling the insured to a presumption of coverage. Such policies are not emblazoned "All-Risks" and their extensive and prolix exclusions create limited coverage that would not intuitively be described as covering all risks of loss.

Rather, a policy is characterized as an all-risks policy based on the interplay between the policy's coverage and exclusion provisions. All-risks policies contain a broad statement of coverage for all "direct physical loss." Coverage is then limited by enumerated exclusions from coverage. Usually, all-risks policies use a standardized form issued by the Insurance Services Office or "ISO" entitled "Causes of Loss—Special Form" that will contain a variant of language stating, in sum or substance: "Covered Causes of Loss means



risks of direct physical loss unless the loss is excluded in Section B or limited in Section C."<sup>1</sup>

New York law recognizes that an essential purpose of all-risks insurance is to provide coverage when the exact cause of loss cannot be established. "All risk insurance arose for the very purpose of protecting the insured in those cases where difficulties of logical explanation or some mystery surround the loss of or damage to property." *Formosa Plastics v. Sturge*, 684 FSupp 359, 366 (SDNY 1987). The insured must establish only a prima facie case that there was a viable all-risks policy and that a fortuitous loss occurred. The insurer then has the burden to prove, both

as a matter of fact and as a matter of policy interpretation, that the loss was caused by something clearly excluded by the policy. In *Great Northern Ins. Co. v. Dayco Corp.*, 637 FSupp 765, 777 (SDNY 1986), the court explained:

*"All-risk insurance arose for the very purpose of protecting the insured in those cases where difficulties of logical explanation or some mystery surround the loss of or damage to property."*

Once the insured has established a prima facie case, the insurer must prove that the claimed loss is excluded from coverage under the policy; the insurer must show that the loss was proximately caused by the excluded peril. The burden on the insurer is especially difficult because the exclusions will be given the interpretation which is most beneficial to the insured.

Similarly, *Simplex diam Inc. v. Brockbank*, 283 AD2d 34, 39 (1st Dept. 2001), stated, "Under an all risks policy an insured need not prove the cause of the loss and is not bound to go further and prove the exact nature of the accident or casualty which, in fact, occasioned the loss."<sup>2</sup>

Consequently, it is critical that the insured's attorney correctly identify an all-risks policy, educate the court about the policy and obtain favorable jury instructions allocating the burden of proof to the insurer.

**Burden Regarding Exceptions to Exclusions?**

New York law, however, is undecided whether the insurer also has the burden of proof regarding "exceptions to exclusions" in all-risks policies. An all-risks policy may exclude a general category of loss from coverage but then re-extend coverage to certain areas within the exclusion through tailored "exceptions" to the exclusion (sometimes called an "endorsement" to the policy). An exclusion for all "collapse" may be modified by an exception extending coverage only to collapses caused by "weight of precipitation." An exclusion for all "earth movement" may have an important exception extending coverage to loss caused by earthquake. The policy assumes a "seesaw" quality whereby its initial broad cov-

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erage provision is materially narrowed through exclusions but then "re-expanded" by exceptions to the exclusions. It is unclear who has the burden of proof regarding such exceptions.

#### Two New York Cases

Two New York courts have commented on the allocation of the burden of proof regarding exceptions to exclusions. In *Atlas Assurance Co. of America v. Newark Center Bldg. Co.*, 1998 WL 160933, \*8 (N.Y. Co. 1998), the insured's claim arose under an exception to an exclusion and the court concluded, without elaboration, that the insurance company "which has the burden of proof, has proffered no viable evidence in support of its denial of liability or as to the amount of damages" (emphasis added). *Atlas*, however, involved a declaratory judgment action brought by the insurer, so the court may have been applying the traditional rule allocating the burden to the plaintiff, rather than consciously holding that the insurer has the burden on exceptions.

In *OTC Int'l Ltd. v. Lloyd's Underwriters*, 2004 WL 235191 (Queens Co. 2004), the court confidently concluded that the insured has the burden of proof regarding an exception. "It is well established that where the existence of coverage depends entirely on the applicability of an exception to an exclusion, the insured has the duty of demonstrating that the exception governs." (quoting *State v. U.W. Marx Inc.*, 209 AD2d 784, 785, 618 NYS2d 135 (3d Dept. 1994)). *OTC*, however, relied exclusively on cases interpreting general liability policies, not all-risks policies. Such cases re-assign the burden to an insured for exceptions in part because the insured has the initial burden of proof under a general liability policy.<sup>3</sup> These cases have questionable relevance to all-risks policies where an insured's initial burden is minimal.

California is the only state whose courts have given specific consideration to the burden of proof regarding exceptions under all-risks policies. In *Strubble v. United Services Automobile Assoc.*, 35 Cal.App.3d 498 (Ct. App. 1973), the court held that the insurer has the burden of proof regarding an exception, concluding, "We, therefore, regard the earthquake endorsement [the exception] as merely narrowing the earth movement exclusion and as not changing the 'all-risks' nature of the underlying policy."

Significantly, in *Aydin Corp. v. First State Ins. Co.*, 18 Cal4th 1183, 959 P2d 1213, 77 CalRptr2d 537 (1998), the California Supreme Court acknowl-

to all-risks insurance in *Formosa, Great Northern, Simplex* and other New York cases suggests the burden of proof must remain with the insurer. This conclusion is buttressed by the fact that many important areas of all-risks coverage now reside in exceptions to exclusions.

But perhaps the unequivocal language of *Marx, Northville* and other cases is decisive on the matter of exceptions, regardless that these cases concerned general liability policies. Until it is resolved, the issue presents the creative insurance practitioner representing either an insured or insurer an important opportunity to obtain litigation advantage.

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edged that *Strubble* correctly allocated the burden to the insurer for exceptions under all-risks policies, but that a different result was warranted for general liability policies. "Under a comprehensive general liability insurance policy such as the one at issue here, by contrast, the insured clearly bears the burden of establishing coverage." Finally, in *Glaziano v. Allstate Ins. Co.*, 2002 WL 987319, \*2 (9th Cir. 2002), the U.S. Court of Appeals for the Ninth Circuit reaffirmed *Strubble*:

Because the [policyholders] are asserting first-party claims on an 'all-risk' policy, [the insurance company] bears the burden of proving that their loss is not covered by the exception to the collapse exclusion.

New York law concerning the burden of proof for exceptions to exclusions is undecided. The strongly pro-policyholder interpretation given

1. For examples of other language deemed to create all-risks coverage, see *York Ins. Co. v. Williams Seafood of Albany*, 273 Ga. 710, 711 (2001) (policy stating "When Special is shown in the Declarations, Covered Causes of loss means RISKS OF DIRECT PHYSICAL LOSS unless loss is [excluded]" was all-risks policy); *Pace Properties v. American Mfrs. Mut. Ins. Co.*, 918 SW2d 883, 885-86 (Mo. Ct. App. 1996) (policy stating "direct physical loss of or damage to Covered Property" was an all-risks policy); *Surbreaker Condominium Assoc. v. Travelers Ins. Co.*, 79 Wash.App. 368 (1996) (policy stating "Covered Causes of Loss—Risks of Direct Physical Loss unless the loss is: Limited...or Excluded" created all-risks policy); *Sentinel Assoc. v. American Mfr. Mut. Ins. Co.*, 804 F.Supp 815, 816 (E.D. Va. 1992) (policy stating "We insure covered property against risks of direct physical loss or damage from external causes [unless loss is excluded or limited]" created all-risks policy).

2. See also *Congregation Beth Torah v. Graphic Arts Mutual Ins. Co.*, 739 NYS2d 454, 455 (2d Dept. 2002) ("defendant [insurer] failed to meet its burden of proving that the loss was within the scope of the policy exclusions it sought to impose").

3. See *Northville Industries Corp. v. National Union Fire Ins. Co.*, 89 NY2d 621, 634, 679 NE2d 1044, 1049, 657 NYS2d 564, 569 (1997) ("Shifting the burden to establish the exception conforms with an insured's general duty to establish coverage where it would otherwise not exist").

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