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Market Space

‘Other insurance’ conflicting clauses can cause collecting headaches

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Insurance policies frequently contain an “other insurance” clause, stating that the policy is excess to any other policy covering the same loss.

The clause limits an insurer’s liability by making it responsible, up to the limits of the policy, only for the amount of loss exceeding all other valid and collectible insurance. This can produce a real headache — and a real coverage problem — when an insured person suffers a loss and has two overlapping policies with the same “other insurance” clause.

On the face of it neither policy would cover the loss because both insurers say they will pay only after the other.

The courts have recognized that giving effect to both clauses would mean denial of primary coverage to the insured. Accordingly, courts will generally disregard both policy clauses and require both insurers to provide primary coverage.

How the losses are apportioned between the carriers can have a meaningful impact on the insured’s recovery.

Two apportionment approaches have gained acceptance: pro rata liability based on policy limits, and equal sharing. The result to the insured can be very different under each approach.

Most states apportion the liability pro rata based on policy limits. Under the pro rata rule, each insurer is liable for a percentage of the total loss equal to the ratio of the insurer’s total policy limit to the sum of the policy limits of all policies covering the risk.

For example, if the limits of policy A and policy B are $1 million and $2 million respectively, policy A will be responsible for a third of the loss and policy B for two-thirds. This rule has been criticized because it penalizes the carrier with greater coverage even though both insurers, by their contracts, have agreed to cover a given loss.

Other states, including Maryland, follow an equal sharing rule under which each insurer is required to contribute equally until the policy with the lower limit is exhausted. Although it is the minority rule, this approach has gained acceptance as being more equitable than the pro rata approach.

In theory, insureds fare well under either rule. Either both insurers contribute pro rata until the policy limits on both policies are exhausted or they contribute equally until the lower policy runs out, and then the remaining policy continues to contribute until it runs out. The insured gets the benefit of both policies.

But there is a hidden danger for the insured if the deductible is materially different in each policy. Depending upon the claim amount, having two policies may actually be detrimental since under either rule, the insured will be required to satisfy the deductible amount on each policy before the policy begins to cover the loss.

For example, suppose policy A provides $1 million in coverage with a $50,000 deductible, policy B provides $2 million in coverage with a $250,000 deductible, and the loss is $210,000. If policy B did not exist, the insured would pay a total of $50,000 and policy A would pay the $160,000 balance of the loss. Because of policy B, however, in an equal sharing state, the insured’s share of the loss would jump to $155,000, policy A would pay only $55,000 and policy B would pay nothing.

The insured fares even worse in a pro rata state. One-third of the $210,000 would be allocated to policy A and two-thirds to policy B. Of the $70,000 allocated to policy A, $50,000 would be paid by the insured toward the deductible and $20,000 would be paid by the carrier.

All of the $140,000 allocated to policy B would be paid by the insured toward the deductible. The carrier would pay nothing. In total, the insured would pay $190,000, policy A $20,000, and policy B nothing; the insured would have paid $140,000 more than

if policy B did not exist.

Only when the loss exceeds the sum of the lower policy deductible, plus the lower policy limits, plus the higher policy deductible does the insured begin to enjoy the benefits of having both policies.

From a cost and coverage perspective, any insured who intentionally wants the coverage limits of two policies should buy a policy that is clearly primary and a second policy that is clearly an excess or umbrella policy. An excess policy having the same limits as a primary policy is both cheaper and often has no deductible.

The lesson here is that an insured with multiple polices that potentially cover the same loss should work with his or her broker to identify clearly which policy provides primary and which policy provides excess coverage. This will result in lower premiums and protect the insured from the potential of having to satisfy multiple retention amounts before having its loss covered. The insured should also ask his or her broker to look for overlapping coverage that may unintentionally put the insured in the position of having two competing “other insurance” clauses.

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