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The Policyholder Law Firm



Insurance Policy Construction Principles: Your Defense Against Purposeful Ambiguities

By Allen R. Wolff and Anna M. Piazza

Insurance policies contain both defined and undefined terms. As the drafter of your insurance policy, your insurance company has likely defined a term when it finds it advantageous to do so, and may leave other terms undefined and purposefully vague. Policy construction principles have evolved to protect the policyholder from the insurance company's maneuverings in this regard. Understanding these principles will prove critical when your insurance company attempts to benefit from an undefined term, especially if that term appears in an exclusion.

How Do I Know if a Policy Term is Ambiguous?

Generally, a policy term is ambiguous if it is susceptible to two or more reasonable interpretations. Ambiguities can arise in insurance policies for a number of reasons. Some courts have held that an undefined term is necessarily ambiguous. Other courts have held that undefined terms are not automatically, but can be, or are more likely to be, ambiguous. Even policy terms that have a clear meaning may become ambiguous in certain factual contexts.

How Do Courts Interpret Ambiguous Policy Terms in My Favor?

Abiding by the principle of *contra proferentum*, courts construe ambiguous terms in an insurance policy against the insurance company and in favor of the policyholder. This rule derives from the fact that insurance policies almost always constitute adhesion contracts comprised of prewritten forms with non-negotiable language imposed by the insurance company.

Contra proferentum applies with even greater force when an insurance company leaves a term undefined. As one court stated, "[W]hen an insurer fails to define a term in a policy, ... the insurer cannot take the position that there should be 'a narrow, restrictive interpretation of the coverage provided.'" *State Farm Fire & Cas. Co. v. CTC Dev. Corp.*, 720 So.2d 1072, 1076 (Fla. 1998). This rule proves especially true where an insurance company leaves a term undefined in an exclusionary clause. See *Krombach v. Mayflower Ins. Co.*, 827 S.W.2d 208, 210 (Mo. 1992) ("[a]mbiguous provisions of a policy designed to cut down, restrict, or limit insurance coverage already granted, or

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introducing exceptions or exemptions must be strictly construed against the insurer”); *Wojtunik v. Kealy*, No. CV-03-2161-PHX-PGR, 2011 U.S. Dist. LEXIS 36229, at *23 (D. Ariz. Mar. 31, 2011) (rule of strict construction in favor of coverage “applies with even greater force where an ambiguity affects an exclusionary clause”).

Courts apply the rule of *contra proferentum* even more strictly when the ambiguity occurs in an exclusion because the insurance company, not the policyholder, bears the burden of proof to show that the exclusion applies. “Any exclusion sought to be invoked by the insurer defendant will be liberally construed in favor of the insured and strictly construed against the insurer unless same is clear and unequivocal.” *Travelers Indem. Co. v. Whalley Constr. Co., Inc.*, 287 S.E.2d 226, 229 (Ga. Ct. App. 1981). See also *State Farm Mut. Auto Ins. Co. v. Jacober*, 514 P.2d 953, 962 (Cal. 1973) (“A layman attempting to interpret an insurance policy... is not likely to have the legal sophistication to deduce what an insurance company is attempting to accomplish by an ambiguous exclusionary clause; it is on just such grounds that our cases have uniformly required that exclusions be ‘conspicuous, plain and clear.’”). “[T]he burden rests upon the insurer to phrase... exclusions in clear and unmistakable language.” *State Farm Mut. Auto Ins. Co.*, 514 P.2d at 958. “[S]o long as coverage is available under any reasonable interpretation of an ambiguous clause, the insurer cannot escape liability.” *Id.* at 954. Unless the insurance company meets that burden, it must extend coverage to the policyholder.

Additionally, *contra proferentum* applies with great force to ambiguous exclusions that the insurance company includes in the policy by way of endorsement. This principle is important; endorsements often deviate from standard form policy language and are tailored to the particular policyholder’s situation. See *San-Nap-Pak Mfg. Co., Inc. v. Firemen’s Ins. Co.*, 47 N.Y.S.2d 542, 546, *aff’d*, 51 N.Y.S.2d 754 (N.Y. City Ct. 1944) (an ambiguous endorsement “which was drawn by the defendant [and “is typewritten unlike the stereotyped printed language of the policy in the main”] should be liberally construed in favor

of the plaintiff and strictly construed against defendant...”).

Where an insurance policy provision is ambiguous, the court — applying *contra proferentum* — may adopt any interpretation in favor of coverage that is reasonable, even if that is not the only reasonable interpretation. As one court noted, “[E]ven assuming that the insurer’s suggestions are reasonable interpretations which would bar recovery by the claimants, we must nonetheless affirm the trial courts’ finding of coverage so long as there is any other reasonable interpretation under which recovery would be permitted in the instant cases.” *State Farm Mut. Auto Ins. Co.*, 514 P.2d at 958-59. “If semantically permissible, an insurance contract will be given such construction as will fairly achieve its object of securing indemnity to the insured for the losses to which the insurance relates.” *Id.* at 959. See also *Champion Int’l Corp. v. Continental Cas. Co.*, 400 F. Supp. 978, 980-981 (S.D.N.Y. 1975), *aff’d*, 546 F.2d 502 (2d Cir. 1976) (“if a policy can be reasonably construed in favor of the position asserted by the insured, he is entitled to recover”).

To determine the meaning of an ambiguous term, a court will consider the meaning that a reasonable person — and not an insurance expert or an attorney — would expect it to have. *Cincinnati Ins. Co. v. Davis*, 265 S.E.2d 102, 105 (Ga. Ct. App. 1980). Furthermore, in construing an insurance policy, courts will consider what a reasonable insured would expect to be covered. *Id.*

How Do These Principles Apply in the D&O Context?

An insurance company cannot exploit an ambiguity in its insurance policy or an unresolved factual issue to deny coverage under a D&O policy. Once the policyholder presents the insurance company with a claim that fits within the policy’s insuring agreement, the insurance company must extend coverage and pay for the costs of defending the directors/officers/company until, if ever, it is established that the claims are not covered by the policy. See *Fleming Fitzgerald & Assocs. v. U. S. Specialty Ins. Co.*, No. 07-1596, 2008 U.S. Dist. LEXIS 76613, *28-29 (W.D. Pa. Sept. 30, 2008).

In situations where it cannot be known whether the exclusion applies until late in a case (i.e., instances where a policy excludes coverage for fraud or for profit to which the policyholder was not entitled), the insurance company must extend coverage to the policyholder, often including the advancement of defense costs, until the issue is fully and finally resolved — even to the point of a final, non-appealable result. *See Great Am. Ins. Co. v. Gross*, C.A. No. 3:05CV159, 2005 U.S. Dist. LEXIS 8003 (E.D. Va. May 3, 2005).

If the unresolved issue is ultimately determined in the insurance company's favor, the insurance company's recourse is to seek recovery from the policyholder of those sums that need not have been advanced. Indeed, insurance companies often include clawback provisions in their policies in contemplation of just such a situation. No reason would exist to include such a provision unless the insurance company knew that it had an obligation to extend coverage until the final adjudication. ▲

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