ZELLE HOFMANN

ZELLE HOFMANN VOELBEL & MASON LLP

The Underwriter's Role Against *Contra Proferentem*

By Christopher R. Paar and Elizabeth V. Kniffen
Published in *Insurance Law360*

The doctrine of *contra proferentem*—literally translated to mean "against the party who proffers"—is a rule of construction that insureds seek to apply in many, if not most, disputes over the interpretation of an insurance policy. Whether in claim-settlement negotiations or litigation, insureds often invoke this rule of construction as if it were an impenetrable position that entitles them to victory if they can conjure more than one interpretation of a policy provision.

Although once a more onerous rule of construction, courts have moved away from the "rigid" approach of construing ambiguous policy provisions against insurers, in favor of a more nuanced approach that considers the insured's level of sophistication and its role in drafting and negotiating the policy language in determining whether to apply *contra proferentem*. *See Jefferson Block 24 Oil & Gas, L.L.C. v. Aspen Ins. UK Ltd.*, 652 F.3d 584, 601 (5th Cir. 2011) (J. Garza, dissenting) (quoting *U.S. Fire Ins. Co. v. Gen. Reinsurance Corp.*, 949 F.2d 569, 573 (2d Cir. 1991)). As emphasized by recent court decisions examining application of this "sophisticated insured" exception, the insurer who is mindful of this exception during the drafting and negotiation process can be in a better position to effectively defend against *contra proferentem* should a dispute as to policy interpretation arise.

Contra Proferentem: A Rule Of Last Resort

It is a fundamental rule of contract interpretation that courts must enforce unambiguous policy terms as written. *Contra proferentem* is a rule of last resort that

should not be considered until a court exhausts all other rules of contract interpretation in resolving an alleged ambiguity. A term is ambiguous only if it is susceptible to more than one reasonable interpretation. Often, courts resolve policy interpretation disputes by interpreting the plain language of the policy without resorting to extrinsic evidence or *contra proferentem*. Upon finding an ambiguity, however, a court will first determine whether the ambiguity can be resolved through extrinsic evidence, including consideration of testimony and documents related to each party's interpretation of the policy language, or through other rules of construction, . If an ambiguity still exists, only then will a court consider whether *contra proferentem* should be applied.

Generally, courts only apply *contra proferentem* to resolve policy disputes in favor of finding coverage for an insured if an ambiguity is unresolved through examination of extrinsic evidence. The rule favors insureds "who have limited bargaining power and fall prey to the large insurance companies who drafted their policies." *Lexington Ins. Co. v. United Health Group, Inc.*, Civ. Action No. 09CV10504-NG, 2011 WL 1467939, at *5 (D. Mass., April 18, 2011). However, if the insured was involved in drafting and negotiating terms in the insurance policy, the "sophisticated insured" exception can preclude application of *contra proferentem*. Because most large commercial entities employ brokers and risk managers who engage in the negotiation and occasional drafting of policy language, *contra proferentem* should be inapplicable in the construction of most large commercial insurance policies.

Current Contours Of The Sophisticated Insured Exception

The sophisticated insured exception precludes the application of *contra proferentem* where the insured "contributes to the drafting of the agreement rather than

adopting a contract of adhesion, the contents of the policy are in some way negotiable, and the insured is as capable as the insurer of interpreting the contract." *Vought Aircraft Indus., Inc. v. Falvey Cargo Underwriting, Ltd.*, *et al*., 729 F. Supp. 2d 814, 824 (N.D. Tex. 2010). The exception also applies where the contract is prepared by a broker acting for the insured. *Id*.

The Fifth Circuit recently considered what constitutes an insured participating in the drafting of a policy. In *Jefferson Block*, the Fifth Circuit held that completing a form provided by the insurer which listed insured locations "does not amount to its drafting or dictating the *terms of the policy*." 652 F.3d at 599 (emphasis in original). Because the form was simply incorporated into the policy's already ambiguous language, the Fifth Circuit held that *contra proferentem* could be applied to the ambiguous language drafted by the insurer. *Id*. Thus, *Jefferson Block* recognizes that the sophisticated insured exception is available as a defense, but for it to apply, there must be more proof than the insured merely filling out a form provided by the insurer.

Although completing forms prepared by the insurer is inadequate proof that an insured participated in the policy's drafting, an insured need not have been involved in drafting of the specific policy language in dispute for the sophisticated insured exception to apply. Rather, it is enough that the insured or its representative had input into the policy terms and that the policy was not a strict contract of adhesion. This point was recently discussed by the Minnesota federal district court in *UnitedHealth Group Inc. v. Columbia Cas. Co.*:

> [T]he Court rejects any notion that the Court must pick through the Policy word-by-word, determine who drafted each word, and, if the word is ambiguous, apply *contra proferentem* against the party who drafted it. This would be an exceedingly strange, not to mention exceedingly

> burdensome, procedure. United has cited no court that has gone about construing an insurance policy in this manner, and United's failure to find support for its position (if, in fact, this is its position) is not surprising.
>
> The *contra proferentem* rule applies when one party-the party with superior bargaining power-exercises total control over the language of the contract and presents the contract to the other party on a take-it-or-leave-it basis. In that situation, it makes sense to place the risk of ambiguity on the party who drafted the contract. In this case, however, two large corporations-neither of which, as far as the record reflects, had superior bargaining power-painstakingly negotiated a unique insurance policy with the assistance of experienced counsel. The Policy was jointly negotiated, and thus the risk of ambiguity should be jointly shared.

No. 05-CV-1289 (PJS/SRN), 2010 WL 317521, at *3 (D. Minn. Jan. 19, 2010) (citation omitted). *See also Lexington Ins. Co.*, 2011 WL 1467939 at *5 (concluding that the insured, United Health, was "not an innocent consumer but rather a sophisticated insurance company who negotiated, and indeed drafted, the terms of their policy.").[1]

A Question Of Fact: Documenting Insured Involvement

In the end, fact questions regarding the involvement of the insured, or its broker, in drafting the policy will be left to the trier of fact. In *Vought*, the federal district court denied summary judgment on a policy interpretation question, concluding that a fact question existed as a result of conflicting evidence regarding the role of the insured's broker, Marsh, in drafting the policy. *Id*. at 827. While Marsh's main representative testified that Marsh drafted the policy, which was a manuscript form, another Marsh representative testified that he had not seen the policy before. *Id*. The court left the

[1] While the "sophisticated insured" exception is widely followed, contract interpretation is a question of state law and its application can vary state by state. For instance, courts differ in what they consider "sophisticated" for purposes of applying the exception. Some courts only require that the insured has equal bargaining power, while others require evidence of actual negotiation, and others require that the insured actually supply the policy terms/form (either directly or through a broker). A few states have refused to recognize the "sophisticated insured" exception or have limited its application. *See e.g., Farmers Auto. Ins. Ass'n v. St. Paul Mercury Ins. Co.*, 482 F.3d 976, 978 (7th Cir. 2007).

question of who drafted the policy to the trier of fact, but noted that the insurer would bear the burden of proof. *Id* at 826-27.

In November 2011, the Eighth Circuit concluded that the doctrine of *contra proferentem* was inapplicable in a dispute over $62.5 million in Iowa flood losses, in part because the evidence was "equivocal on the identity of the drafter of the policy form, given the back-and-forth nature of the drafting process and relatively equal bargaining power of the parties." *Penford Corp. v. Nat'l Union Fire Ins. Co.*, 662 F.3d 497, 505, (8th Cir. 2011). Both *Vought* and *Penford* emphasize that properly documenting policy negotiation and drafting can determine the outcome of a dispute regarding application of *contra proferentem*.

It is doubtful that any underwriter is focused on the applicability of the doctrine of *contra proferentem* when he or she is formulating the policy terms with the input of the insured and its broker. However, the significance of the role of the insured and its broker to policy interpretation questions cannot be overstated, and an underwriter should preserve communications and notes which reflect the insured's involvement in drafting and negotiating the policy. For example, documents or notes which show: (1) an insured's specific edits to policy provisions; (2) communications with the insured or broker regarding use of a specific industry form, provision or language; or (3) the use of a broker form will be important evidence in establishing the insured's role in the drafting process. By properly documenting the underwriting and policy negotiations, insurers can better prepare to defend against *contra proferentem* and ultimately support a finding regarding the application of the "sophisticated insured" exception in the event a coverage dispute should arise.

*****

Christopher Paar is a partner in the Minneapolis, Minnesota office of Zelle Hofmann Voelbel & Mason LLP. Elizabeth Kniffen is an associate in the firm's Minneapolis office. Zelle Hofmann is a national law firm representing clients in their most challenging insurance-related disputes, antitrust/competition and other complex business litigation. The views and opinions expressed herein are solely those of the authors and do not reflect the views or opinions of Zelle Hofmann or any of its clients. For additional information about Zelle Hofmann, please visit www.zelle.com.