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Ambiguity and the interpretation of insurance policies in California

By J. Robert Renner

Over the last 25 years, the state Supreme Court has stated various iterations of a two or three part test for interpreting insurance policies, most typically: first, “plain meaning” — if the policy language is clear and explicit, it governs; second, the insured’s “reasonable expectations” — if the policy terms are ambiguous, they will be interpreted to protect the objectively reasonable expectations of the insured; and third, “contra insurer” — if the prior rules do not resolve an ambiguity, the ambiguity will be resolved against the insurer as the drafter of the policy. E.g., *Minkler v. Safeco Ins. Co. of America*, 49 Cal.4th 315 (2010).

At the same time, the state Supreme Court has repeatedly stated that insurance policies are contracts to which the ordinary rules of contract interpretation apply. E.g., *Powerine Oil Co., Inc. v. Superior Court*, 37 Cal.4th 377 (2005). It is provided by statute in California that “[a]ll contracts, whether public or private, are to be interpreted by the same rules.” Civil Code Section 1635.

Can these statements be reconciled? In other words, is the Supreme Court’s test for policy interpretation consistent with the ordinary rules of contract interpretation in California? I believe the answer is yes, but only if one allows for a proper understanding of the meaning of “ambiguity.”

The concept of ambiguity serves several distinct functions in the law of contract interpretation. At a threshold level, some minimal degree of uncertainty in the language of a contract is required before a court can even engage in a process of interpretation. Civil Code Sections 1637 and 1638. “Where the language of a contract is clear and not absurd, it will be followed. But if the meaning is uncertain, the general rules of interpretation are to be applied.” *Edwards v. Arthur Andersen LLP*, 44 Cal.4th 937 (2008).

In many states, a judicial determination of ambiguity is a prerequisite for the admission of extrinsic evidence to aid in the interpretation of an integrated contract. This appears to have been the law in California

prior to 1968, when the state Supreme Court adopted a rule allowing for the admission of extrinsic evidence wherever “relevant to prove a meaning to which the language of the contract is reasonably susceptible.” *Pacific Gas & Electric Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal.2d 33 (1968).

Finally, California’s statutory rules for contract interpretation provide that “[i]n cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist.” Civil Code Section 1654. This rule — that ambiguities are to be resolved against the drafter of the contract — is intended to be used only where the uncertainty cannot be remedied by other rules of interpretation, including the consideration of any available extrinsic evidence. *Steller v. Sears, Roebuck & Co.*, 189 Cal.App.4th 175 (2010).

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Ambiguity, as used in the state Supreme Court’s three-part policy interpretation test, should be understood to be of the latter type, i.e., as a default rule, or set of rules, to be applied only in the event that general canons of construction or other aids to interpretation fail to resolve an uncertainty in the contract terms. In this regard, the Supreme Court has expressly stated that policy provisions are ambiguous only if they are capable of two or more reasonable constructions, that the policy terms must be construed in the context of the whole policy and in the circumstances of the case, and cannot be found to be ambiguous in the abstract. E.g., *County of San Diego v. Ace Property & Casualty Ins. Co.*, 37 Cal.4th 406 (2005). “Context,” as used here, signifies the application of general canons of construction, while “circumstances of the case” signifies the consideration of extrinsic evidence, to the extent such evidence is

available and is offered by the parties. Only after these factors are considered can a policy be considered ambiguous for purposes of protecting the objectively reasonable expectations of the insured, or of applying a contra insurer construction.

Not surprisingly, a great deal of attention is devoted in the Supreme Court’s case law to determining the plain meaning of policy language, if any can be found, since this inquiry includes within it the application of the full slate of statutory and judicially-developed canons of construction. E.g., Civil Code Sections 1635-1663; Civil Procedure Code Sections 1856-1866.

Likewise, it is perhaps also not surprising that some of the court’s opinions appear to consolidate the second and third steps of the policy interpretation test into one, stating that, if an ambiguity cannot otherwise be resolved, courts will construe the ambiguity against the party that caused the uncertainty to exist — the insurer — in order to protect the insured’s reasonable expectation of coverage. E.g., *La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co.*, 9 Cal.4th 27 (1994). To the extent that the triggering understanding of ambiguity is the same in both instances — as a tiebreaker rule once other rules are exhausted — there may be much sense to consolidating these steps.

One should ask what purpose is served by articulating separate rules for interpreting insurance policies, as distinct from other varieties of contracts. At least in some cases, insurance policies have important distinguishing features. They commonly involve parties in an unequal bargaining position, with an unsophisticated consumer on one side and a large corporation on the other, and the use of form documents prepared by the insurer and presented to the customer on a take it or leave it basis. To the extent that there is no actual bargaining over policy terms, moreover, there may be no extrinsic evidence of negotiation to be considered. An extreme example found in the case law from the 1960s is of an individual who purchased an airplane trip insurance policy from an airport vending machine,

with no opportunity to read the policy prior to purchase, and was killed in an airplane crash on a return leg of the journey. The insurer argued (unsuccessfully) that a substituted air-taxi flight was excluded from coverage. *Steven v. Fidelity & Casualty Co.*, 58 Cal.2d 862 (1962).

Special or simplified interpretation rules may well be appropriate in such cases, in that they are classic adhesion contracts. They will not work as well in more complex commercial contexts. Corporate purchasers of insurance are often represented by expert risk managers and independent brokers, may have significant market power, and can negotiate specific policy terms. In some instances, a policy provision may be drafted by the insured or its agent and merely underwritten by the insurer. In any event, regardless of whether one applies simplified rules of policy interpretation or the full panoply of the general canons of contract construction, the final outcome should theoretically be the same. Were it otherwise, the court would not be honoring the statute that requires that all contracts are to be interpreted by the same rules.

In the end, a simplified test is just that, a simplified test. The full set of rules of contract interpretation are too complicated to be easily summarized at the outset of a judicial opinion. Of necessity, an appellate court shortens and simplifies the rules in stating the law in the preamble to its opinion. The resolution of any difficult question of interpretation will still require the consideration of the context in which the language appears, and the circumstances of the case. In California, policy provisions cannot be ambiguous in the abstract.

The opinions expressed are those of the author and do not necessarily reflect the views of the firm or its clients.



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