Insurance Policies: Canons of Construction

By Deborah I. Hollander

Most contracts are interpreted to effect the "mutual intention" of the parties, the presumption being that the parties had equal bargaining power. However, different standards of construction are applied to insurance policies than to ordinary contracts. New Jersey courts do not presume equal bargaining power between the parties, and insurance policies traditionally are viewed as drafted entirely by the insurer, signed without alteration or even consideration by the insured.[1] Rather than attempt to determine actual intent, New Jersey courts interpret the policy to meet the average insured's reasonable expectations.[2]

Further, because insurance is considered a socially beneficial means by which the risk of loss is spread throughout the entire community,[3] the construction of policies is a matter of significant public interest in a way that an ordinary contract is not.[4] New Jersey courts thus have developed a set of principles guiding the construction of insurance policies. These include expansive canons, which support broad coverage; qualifying canons, which focus on the actual language of the policy; and public policy canons, which recognize the roles of legislation and regulation in shaping policies.

The Canons of Expansive Construction

Insurance Policies Should Be Construed To Favor Coverage

This canon is usually expressed in one of two ways: "[w]here the policy language supports two meanings, one favorable to the insurer and the other to the insured, the interpretation favoring coverage should be applied;"[5] or "policies should be construed liberally in [the insureds'] favor to the end that coverage is afforded."[6] It recognizes that insurance is the most effective means of spreading the risk of loss and ensuring that injuries are adequately compensated. Recently, however, this canon has been supplanted by the next, somewhat more restrictive canon.

Insurance Policies Should Be Construed to Meet the Objectively Reasonable Expectations of the Insured

This canon represents the most precise formulation of the pro-insured standard of construction.[7] It sometimes is cited without regard to limitations imposed by the insured's "objectively reasonable expectations."[8] For a court to construe a policy in favor of the insured's expectations, the insured must demonstrate that those expectations were not subjective and were not a misunderstanding on his or her part; the insured can always argue that he or she expected coverage and that his or her expectation was reasonable.

Insurance Policies Are Contracts of Adhesion and Should Be Construed Against the Insurer

This canon, derived from standard contract law, presumes that insurers draft policies to favor themselves and to be uniform. It paints the policyholder as an unsophisticated consumer. Consequently, courts are less apt to invoke this canon when the particular insured is a "sophisticated business."[9] In particular, corporations may be denied the benefit of this expansive canon of interpretation if the policy was purchased through a risk management specialist or an insurance broker.[10]

Ambiguities Should Be Construed Against the Insurer and In Favor of the Insured

Because the insurer drafts the language of the insurance contract, it may not argue that vague or ambiguous language should be construed in its favor.[11] Insurers are viewed as sophisticated drafters, capable of taking full advantage of interpretive issues of which the policy purchaser is unaware.[12] Nonetheless, ambiguities can arise by words or phrases with more than one meaning[13] and confusing policy structure, *i.e.*, delineation of coverage and exclusions through examples rather than definitions.[14] Courts are likely to find an ambiguity where alternate phrasing or clearer definitions could have been chosen.[15]

The Insurance Policy Should Be Construed as a Whole

This canon supports consistency amongst policy provisions.[16] Although a review of the overall policy can support either an expansive or restrictive view of coverage, this canon is invoked to do away with any limitations on coverage where that coverage had been defined generally in the most conspicuous part of the policy.[17]

Exclusions Should Be Narrowly Construed

New Jersey courts take a particularly harsh view of those clauses that limit general grants of coverage. Because most insurance purchasers buy policies according to the type and amount of coverage, they are unlikely to have scrutinized the excluded risks.[18] Exclusionary clauses are often seen as "hidden pitfalls."[19] An exclusion that exempts from coverage a risk that the insured reasonably expected to be covered must be clear and conspicuous.

Exclusions Must Be Specific, Not General

Because they detract from the coverage purchased, exclusions must be narrowly drawn, and the risks excluded must be specific and enumerated.[20] Attempts to broaden exclusions by analogy will be rebuffed.[21] Moreover, where a loss is caused by the occurrence of both a covered risk *and* an excluded risk (such as covered fire damage and excluded weather damage), the two risks will merge so that the loss will be attributed to the covered risk.[22]

Where the Policy Provision Under Examination Relates to the Inclusion of Persons Other Than the Named Insured, a Broad and Liberal View Is Taken of the Coverage Extended

The opposite of an exclusionary clause is a clause that extends coverage beyond the named assured, such as to members of the insured's household.[23] In such instances, it is presumed that the clause was intended to broaden coverage and that a broad interpretation of the contract as a whole is therefore appropriate.[24]

The Literal Language of a Policy May Not Defeat the Legitimate Expectations of the Insured

This canon is the most extreme expression of the pro-insured bias and may override plain and unambiguous language; it is tantamount to estoppel and applies only in exceptional cases.[25] It is best argued when the insurer has changed positions on coverage after a claim has been made or where the insurer's actions or subsidiary documents assured the insured of coverage not provided in the policy.[26]

The Canons of Restrictive Construction

The canons of expansive construction are counterbalanced by canons that are more cautious, pay closer heed to the actual language and structure of the policy, and generally support a more restrictive view of coverage.

An Unambiguous Insurance Policy Will Be Enforced According to Its Terms

An expansive construction of a policy is justified when the policy language is so confusing that the average policyholder cannot make out the boundaries of coverage.[27] Otherwise, clear and direct policy language should be given effect.[28] This canon also recognizes that expansive construction is not creative license, but an attempt to determine the true and fair intent of the policy.[29] Courts have criticized a demand for an expansive interpretation of clear language as an attempt to "emasculate" or contort the policy.[30]

The Court Should Not Write a Better Policy of Insurance Than the One Purchased

This canon cautions against extending coverage or otherwise tilting the stated contractual obligations toward the insured so as to give the insured a better bargain than that for which he or she contracted. It applies when the insured seeks an interpretation that would change the intent of the policy or is inconsistent with the course of dealing of the parties.[31] It also may defeat claims that are in essence generalized warranty claims and "business risks" more properly ascribed to the insured.[32]

Exclusions That Are Clear and Unambiguous Will Be Enforced

Restrictive canons apply both to general policy terms and exclusions.[33] Although generally disfavored, courts recognize that certain exclusions can reinforce, rather than limit, the general intent of the policy. Thus, if an exclusion restricts coverage that would be available under a different policy or excludes a risk not generally considered within the scope of the policy, the exclusion will be upheld.[34]

Exclusion Clauses Subtract From Coverage Rather Than Grant It

This canon holds that an exclusionary clause should not nullify a second exclusionary clause or otherwise enhance coverage.[35] It also cautions against importing definitions from other parts of the contract when doing so would frustrate the restrictions of the exclusion.[36]

The Canons of Regulatory Construction

Both expansive and restrictive canons presume that insurance policies are essentially private transactions. More recently, courts have recognized that the insurance industry is heavily regulated. Many policy provisions, particularly in automobile[37] and health insurance policies,[38] are mandated by statute, not insurer initiatives, and/or are subject to regulatory approvals. A set of canons that reflect the greater significance of regulatory control is emerging.

If Terms In an Insurance Policy Are Included by Statutory Mandate, Ordinary Rules of Statutory Construction Apply

This canon holds that if the legislature decries that a certain term must be included in a policy, the policy is not a contract of adhesion.[39] Interpretation of such terms may benefit either the insured or the insurer. Courts are likely to construe terms of coverage in consumer policies as fulfilling a strong mandate for broad coverage.[40] Anti-fraud provisions and antistacking provisions, however, tend to be interpreted in favor of insurers.[41]

Terms Approved by the Commissioner of Insurance Will Be Construed According to the Explanation Submitted

In *Morton International, Inc. v. General Accident Insurance Co. of America*, the court held that the meaning of the terms "sudden and accidental" in the standard "pollution exclusion clause" must be construed according to the meaning offered by insurers when the insurers sought to have the clause added to most general liability policies.[42] The court ruled that because the Commissioner had acted on behalf of prospective insureds, his "intent" and understanding of the terms proffered served as a surrogate for the purchaser's intent and understanding, and his approval was a proxy for mutual consent and binding.[43]

Although *Morton* is the first case in which the submission to the Commissioner of a proposed term served to resolve an ambiguity, other cases have implicitly relied on the Commissioner's understanding or acceptance of terms.[44] The principle of *Morton* logically cannot be restricted to environmental insurance policies. Therefore, this canon of construction may apply to the wide variety of policies subject to regulatory approval.

Where Ordinary Canons of Interpretation Are Not Applicable and the Insurance Policy Does Not Easily Admit to One Interpretation, Public Policy May Serve as a Guide

In *Owens-Illinois, Inc. v. United Insurance Co.*,[45] the court noted that neither the insurers nor the insured was likely to have anticipated "long-tail" asbestos liability when entering into occurrence-based policies that extended over a number of years. The court thus held that such policies should be construed with an eye toward three policy concerns: (1) the need for coverage; (2) the need to allocate risks to prevent toxic damage; and (3) the need for general efficiency in allocating claims.[46]

Whether public policy analysis will supersede contract analysis in other circumstances remains to be seen. However, if this ruling is extended, it will mark a trend toward looking outside the four corners of a policy to resolve coverage disputes.

Conclusion

Perhaps the best expression of how the New Jersey Supreme Court views these issues was expressed by Justice Marie L. Garibaldi in *Voorhees v. Preferred Mutual Insurance Co.*:[47]

> [A]n insurance policy should be interpreted according to its plain and ordinary meaning. But because insurance policies are adhesion contracts, courts must assume a particularly vigilant role in ensuring their conformity to public policy and principles of fairness. When the meaning of a phrase is ambiguous, the ambiguity is resolved in favor of the insured, and in line with an insured's objectively reasonable expectations. Moreover, if an insured's 'reasonable expectations' contravene the plain meaning of a policy, even its plain meaning can be overcome. Nonetheless, courts 'should not write for the insured a better policy of insurance than the one purchased.'

The court did not rest its decision on these apparently contradictory principles alone. It went on to analyze the precise provisions at issue under both judicial precedent and public policy. A successful practitioner will do likewise, bringing these canons of construction to bear on the policies and facts of the case.

Deborah I. Hollander *is a graduate of Georgetown University Law Center and is a member of the Insurance Law Committee of the NJSBA.*

Endnotes

1. *Linden Motor Freight Co. v. Travelers Ins. Co.*, 40 N.J. 511, 524-25 (1963).
2. *Werner Indus., Inc. v. First State Ins. Co.*, 112 N.J. 30, 35 (1988); *Sparks v. St. Paul Ins. Co.*, 100 N.J. 325, 338 (1985).
3. *Owens-Illinois, Inc. v. United Ins. Co.*, 138 N.J. 437, 472 (1994).
4. *Meier v. New Jersey Life Ins. Co.*, 101 N.J. 597, 613 n.11 (1986)(citing Note, "Insurance-Construction of Policy Terms," 1954 Wis. L. Rev. 335, 336 (1954)).
5. *Lundy v. Aetna Cas. & Sur. Co.*, 92 N.J. 550, 559 (1983).
6. *Kievit v. Loyal Protect. Life Ins. Co.*, 34 N.J. 475, 482 (1961).
7. *E.g., Aubrey v. Harleysville Ins. Cos.*, 140 N.J. 397 (1995); *Werner Indus.*, 112 N.J. at 35.
8. *E.g., Lehrhoff v. Aetna Cas. and Sur. Co.*, 271 N.J. Super. 340, 351 (App. Div. 1994).
9. *National Sur. Co. v. Allstate Ins. Co.*, 115 N.J. Super. 528, 535 (Law Div. 1971).
10. *Owens-Illinois*, 138 N.J. at 437.
11. *E.g., Meier*, 101 N.J. at 612.
12. *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 249 (1979) (Pashman, J., dissenting).
13. *Edgewater Nat'l Banking Corp. v. Safeguard Ins. Co.*, 81 N.J. Super. 383 (App. Div. 1963) (construing the word

Continued on page 27

Realty, 218 N.J. Super. at 532-33.

5. *Morton Intern.*, 134 N.J. at 80-87.
6. *Id.* Although *Morton* is often cited as a victory for policyholders, the insured in that case lost. The court upheld the exclusion as a bar to coverage sought by an egregious active polluter. The facts showed that the insured, the owner-operator of an industrial plant, knowingly and repeatedly discharged mercury-laden wastes into surface waters, despite awareness that mercury was a dangerous substance and repeated warnings of state regulators. *Id.* at 87-95.
7. *Broadwell Realty*, 218 N.J. Super. at 519.
8. *See CPS Chemical v. Continental Ins. Co.*, 222 N.J. Super. 175, 186-87 (App. Div. 1988); *Broadwell Realty*, 218 N.J. Super. at 526-28; *Lansco v. Department of Environ. Protec.*, 138 N.J. Super. 275, 282-85 (Ch. Div. 1975), *aff'd*, 145 N.J. Super. 433 (App. Div. 1976), *certif. denied*, 73 N.J. 57 (1977).
9. *Reliance v. Armstrong World Indus.*, 265 N.J. Super. 148 (Law Div. 1993), *appeal pending*, Docket No. A-703-93T3. *See contra, UMC/Stamford v. Allianz Underwriters Ins. Co.*, 276 N.J.Super. 52 (Law Div. 1994).
10. *Morrone v. Harleysville Mut. Ins. Co.*, __ N.J. Super. __ (App. Div. 1995).
11. *Owens-Illinois, Inc. v. United Ins. Co.*, 138 N.J. 437 (1994).
12. *Voorhees v. Preferred Mut. Ins. Co.*, 128 N.J. 165, 173 (1992).
13. *Burd v. Sussex Mut. Ins. Co.*, 56 N.J. 383 (1970). *See also Hartford Acc. & Indem. Co. v. Aetna Life & Cas. Ins. Co.*, 98 N.J. 18, 24-25 (1984); *CPS Chem. Co. v. Continental Ins. Co.*, 203 N.J. Super. 15 (App. Div. 1985).
14. *Owens-Illinois*, 138 N.J. at 474.
15. In *Owens-Illinois*, the Supreme Court appeared to signal its concern about the duty to defend. Lamenting the economic inefficiency of the present toxic waste cleanup system and the large sums diverted to coverage litigation, the court encouraged insurers to step forward and voluntarily defend their insureds: "In future cases, insurers aware of their responsibility under the continuing trigger theory might minimize their costs by assuming responsibility for or involving themselves in the defenses of the actions with the ultimate allocation of costs to be determined in accordance with the same general formulas." *Id.* at 478.
16. *Rutgers, The State University of N.J. v. Liberty Mut. Ins. Co.*, 227 N.J. Super. 571 (App. Div. 1994), *certif. granted*, 140 N.J. 274 (1995).

Insurance Policies: Canons of Construction

Continued from page 10

"theft" to include employee conversion as well as ordinary larceny).

14. *Lehrhoff*, 271 N.J. Super. at 368 (construing policy to provide coverage to named insureds listed on declaration page, despite qualifying language elsewhere in policy).
15. *Mazzilli v. Accident & Cas. Ins. Co. of Winterthur*, 35 N.J. 1, 8-9 (1961); *e.g., Ariston Airline & Cater. Supp. Co. v. Forbes*, 211 N.J. Super. 472 (Law Div. 1986)(comparing language of policies of two carriers and finding less precisely drafted policy ambiguous).
16. *E.g., Travelers Ins. Co. v. Leonard*, 120 N.J. Eq. 6 (Ch. 1936)(when policy is construed as a whole, the date on which a life insurance policy may be rescinded for fraud is inclusive of the anniversary of the binding date and is not extended for one further day).
17. *Lehrhoff*, 271 N.J. Super. at 340.
18. *Kievit*, 34 N.J. at 488. *E.g., Wickner v. American Reliance Ins. Co.*, 273 N.J. Super. 560, 568 (App. Div. 1994), *aff'd*, 141 N.J. 392 (1995) (court does not presume that homeowners are aware of exclusion from coverage once property has been sold).
19. *Kievit.*, 34 N.J. at 482.
20. *Capece v. Allstate Ins. Co.*, 88 N.J. Super. 535, 541 (Law Div. 1965).
21. *E.g., Ariston Airline & Cater. Supp. Co*, 211 N.J. Super. at 472 (exclusion for damage due to earth movement does not extend to damage due to freezing and thawing of ground).
22. *Id.*
23. *Mazzilli*, 35 N.J. at 8-9 (construing the word "household" to include ex-wife who lived in separate house on same property).
24. *Arents v. General Accident Ins. Co.*, 280 N.J. Super. 423 (App. Div. 1995)(construing "household" to include son).
25. *E.g., Doto v. Russo*, 140 N.J. 544 (1995).
26. *Id.* (insurer estopped from denying coverage its agent advised would be provided).
27. *State v. Signo Trading Int'l, Inc.*, 130 N.J. 51, 62-63 (1992).
28. *Id. E.g., Kowalski v. Travelers Ins. Co.*, 115 N.J. Super. 545 (Law Div. 1971)(group employee benefits policy that specified insurance coverage would be terminated upon employee's discharge enforced literally, notwithstanding that employer was later found to have discharged employee illegally).
29. *Allstate Ins. Co. v. Schmitt*, 238 N.J. Super. 619 (App. Div.), *certif. denied*, 122 N.J. 395 (1990) (exclusion for barring recovery for injuries reasonably expected to occur from intentional acts clearly covers liability from knife attack).
30. *Stiefel v. Bayly, Martin & Fay*, 242 N.J. Super. 643, 651 (App. Div. 1990).
31. *E.g., Werner Indus., Inc.*, 112 N.J. at 30 (excess policy will not be interpreted to provide primary coverage where insured's primary carrier had gone bankrupt, particularly where insured had sought compensation for first level of coverage before raising such assertion against excess carrier); *Stiefel*, 242 N.J. Super. at 651 (umbrella policy not interpreted to include underinsured motorist's coverage where insured had purchased extra underinsured motorist's coverage on another vehicle also covered by umbrella policy).
32. *E.g., National Sur. Co.*, 115 N.J. Super. at 528 (cargo company could not collect for damage to goods transported under business risk exclusion).
33. *See e.g., Wickner*, 273 N.J. Super. at 560 (exclusions from coverage for business risks and previously owned premises were clear and enforceable).
34. *See Weedo*, 81 N.J. at 247 (no amount of semantic ingenuity can be brought to bear on a fire insurance policy so as to afford coverage for an intersection collision).
35. *Id.* at 247 (a separate exclusionary clause cannot be used to negate general exclusion of business risks).
36. *See Paul Revere Life Ins. Co. v. Haas*, 137 N.J. 190, 199 (1994); *cf., Capece*, 88 N.J. Super. at 541.
37. N.J.S.A. 39:6A-1 *et seq.*
38. N.J.S.A. 17:48-6.14.
39. *Paul Revere Life Ins. Co.*, 137 N.J. at 199.
40. *E.g., Lindstrom v. Hanover Ins. Co.*, 138 N.J. 242 (1994)(construing statutory coverage of no-fault personal injury protection benefits to include coverage of injuries from drive-by shooting).
41. *E.g., Aubrey*. 140 N.J. at 397 (interpreting anti-stacking statute of underinsured motorist's coverage to deny motorist coverage under limits of borrowed vehicle rather than her own UIM coverage); *Paul Revere Life. Ins. Co.*, 137 N.J. at 190 (construing rescission clauses mandated by legislature as anti-fraud measure in favor of insurer).
42. 134 N.J. 1, 76 (1993).
43. *Id.* at 76-78.
44. *E.g., Hartford Ins. Co. v. Allstate Ins. Co.*, 127 N.J. Super. 460 (App. Div. 1974), *aff'd*, 68 N.J. 430 (1975)(where Commissioner had approved automobile policy, it must be presumed clause was within public policy, notwithstanding that its application disappoints insured).
45. *Owens-Illinois*, 138 N.J. at 437.
46. *Id.* at 472.
47. 128 N.J. 165, 175 (1991)(citations omitted).