IRG INSURANCE RESEARCH GROUP
John K. DiMugno, Attorney-at-Law

Insurance Research Group/John K. DiMugno, Attorney-at-Law

3450 Palmer Dr., Suite 4-285
Cameron Park, CA 95682

Phone: 530-344-0239
Fax: 530-344-0189
Email: jd@dimugnolaw.com

Contra Proferentem and "Sophisticated" Insureds under the Restatement Law of Liability Insurance

By John K. DiMugno

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My last post examined the role of extrinsic evidence and the insured's objectively reasonable expectations in resolving insurance policy ambiguity under the proposed Restatement, Law of Liability Insurance. This post explores the Restatement's treatment sophisticated insureds, typically large corporations with risk managers and their own insurance brokers.

Sophisticated Insured Exception Rejected

Although § 4 of the Restatement recognizes that the sophistication of an insured is relevant to the determination of what an objectively reasonable insured in the insured's position would have understood, the section categorically rejects creation of a sophisticated insured exception to the rule that insurance policy ambiguities are to be construed against the insurer. At meetings with the Advisors and Members Consultative Group, the Reporters expressed the concern that distinguishing between or among policyholders based on their level of sophistication would undermine the project's goal of promoting uniformity in the interpretation of insurance policies and provide fodder for coverage litigation.

Comment (n) to § 4 recognizes two situations in which *contra proferentum* may be applied *against* the policyholder: (1) when the policyholder negotiates and drafts policy language; and (2) when the policyholder requests a standard-form term that is not ordinarily used by the insurer. In the later instance, the standard-form term selected by the policyholder is interpreted against the policyholder only if the parties negotiate to apply a different contract interpretation principle to the term and memorialize their agreement in an endorsement or separate writing.

Otherwise, the Restatement's rules of policy interpretation are mandatory and apply regardless of the insured's sophistication.

The Restatement's position is contrary to rule adopted in some states that doctrines such as "reasonable expectations" and *contra proferentem* do not apply to "**sophisticated insureds**." [Link to *Owens-Illinois, Inc. v. United Ins. Co.,* 138 N.J. 437, 650 A.2d 974, 991 (N.J. 1994)] Other jurisdictions, such as California, apply the *contra proferentum rule* in a manner similar to the Restatement's proposal. In *AIU Ins. Co. v. Superior Court*, 51 Cal.3d 807, 823, 832, 274 Cal.Rptr. 820, 799 P.2d 1253 (1990), the California Supreme Court made clear that the relative sophistication of the insured has no effect on the interpretation of insurance policies written by the insurer. *AIU* permits courts to depart from the normal rules of policy interpretation "only where there is evidence that the provision in question was jointly drafted; merely showing that policy terms were negotiated, and that the insured had legal sophistication and substantial relative bargaining power is not enough." The issue, however, remains unresolved in most jurisdictions.

Definitional Difficulties

Underlying the reluctance of courts, and the Restatement's drafters, to adopt a sophisticated insured exception to the *contra proferentum* rule is the difficulty of finding a principled basis for determining when an insured is "sophisticated" enough to understand insurance coverage in a manner that most insured's do not. Should the deference accorded the insured's expectations relate inversely to the insured's size? At what size does a corporate insured becomes sophisticated? If size is not the sole determinant, what else should courts consider? Should insurers be allowed to conduct discovery into an insured's risk management staff, use of outside brokers, and whether the insured has ever elected to self-insure or be insured by a captive insurer? Should an insured's previous involvement in coverage litigation over similar issues be relevant to the insured's reasonable expectations, particularly if similar coverage issues were resolved against the insured?