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Court Split Over Contra Proferentem Doctrine Widens


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Law360, New York (January 06, 2014, 4:38 PM ET) -- Contra proferentem is a rule of insurance contract interpretation under which ambiguities in an insurance contract are construed against the drafter. Because insurers typically draft insurance contracts, this rule of contract interpretation usually works in favor of the insured. But what if the dispute over insurance contract language is between two insurers rather than between the insurer and its insured? In Economy Premier Assurance Co. v. Western National Insurance Co., No. A13-0621, 2013 Minn. App. (Minn. Ct. App. Nov. 25, 2013), the Minnesota Court of Appeals addressed that question. There, the court ruled that the contra proferentem doctrine does not apply to resolve ambiguities in insurance contract language in coverage disputes between two insurers.

The Contra Preferentem Doctrine

In ordinary noninsurance contract litigation, the contra proferentem doctrine is often used as a last resort to resolve ambiguous contract language or, as one commentator put it, "a late-inning tiebreaker, one used when the more probative and obvious methods have failed." 1 Jeffrey W. Stempel, Law of Insurance Contract Disputes § 4.04, at 4.08, at 4-60.1 (2d ed. 2002). But while the contra proferentem rule is usually a construction tool of last resort in ordinary contract litigation, it has been used by some courts as an interpretive rule of first resort in insurance contract disputes. Id. § 4.08[a], at 4-66.

This was not always the case. Indeed, insurance contracts used to be construed much like any other business contracts. But this changed when insurance policies were mass marketed. Unlike a negotiated business contract, these insurance policies used standardized language drafted by the insurer and effectively became "contracts of adhesion." Thus, policyholders typically had no bargaining power and no effective means of changing the terms of the insurance contract. The courts' logical reaction to this was to place the onus of ambiguous terms on the insurers, because they had the better bargaining position and were in a better position to avoid the ambiguity. Id. § 4.05, at 4-24.

Underlying Facts

Luke Hylden was driving his father's pickup truck, insured by Economy Premier, when he collided with another car and injured the driver Sheila Smith. Luke's parents were divorced, and Luke was living with his mother at the time. Hylden's father had lent Luke the truck because the car Hylden usually drove, owned by his mother and insured by Western National, had broken down. Luke was an insured under the policies issued by both Economy Premier and Western National.

After the accident, collision, Economy Premier, paid $212,000 to the injured driver. Economy Premier then sued Western National seeking reimbursement, claiming that Western National, not Economy Premier, was responsible for the primary coverage.

Both policies included "other insurance" clauses which purported to make each insurer's liability excess over any other collectible insurance, including where the insured was driving a "temporary substitute" vehicle. But Western National's "other insurance" clause included an additional paragraph that provided that Western National's coverage was primary where the insured is driving a "temporary loaned vehicle."

Therefore, the dispute centered on the phrase "temporary loaned vehicle." The phrase was ambiguous because it reasonably could be construed to mean: (1) only those vehicles provided temporarily by repair shops while a covered vehicle is being serviced or (2) any vehicle that was loaned to someone while a covered vehicle was being repaired (like the pickup truck that Luke Hylden's father loaned him).

Because the phrase "temporary loaned vehicle" was ambiguous, Economy Premier argued that it should be construed against Western National, the drafter, which would make Western National's coverage is primary.

The Court's Rationale

The Minnesota Court of Appeals declined to find the court ruled the contra proferentem doctrine applicable in a dispute between two insurers. To that end, the court examined the rationale behind the doctrine.

It observed that the doctrine recognizes the disparity in bargaining power that typically exists between an insurer and its insured and that insurance contracts are often contracts of adhesion. The court also noted that the doctrine's rationale is that the proponent of a contract term is more likely aware of its possible ambiguities, especially when dealing with standardized contracts. Thus, the court noted that the rule protects the insured that is often at a disadvantage in terms of knowledge, expertise and bargaining power compared to the insurer. The court also pointed out that the contra proferentem doctrine provides an incentive for drafters, who are in a better position to prevent misunderstandings, to avoid ambiguities.

Based on the rationale of the contra proferentem doctrine, the court found it inapplicable in coverage disputes between two insurers, one of which was not a party to the disputed contract. The court reasoned that Economy Premier offered no reason to conclude that the doctrine should be applied to construe ambiguous contract terms against an insurer and in favor of another insurer who was a stranger to the contract. The court also noted that most of the other jurisdictions that had addressed this same issue also concluded that the contra proferentem doctrine did not apply to resolve ambiguities in insurance contract language in coverage disputes between two insurers.

The court ultimately resolved the dispute in favor of Western National — that is, "temporary loaned vehicle" meant only those vehicles provided temporarily by repair shops while a covered vehicle is being serviced — from a "neutral perspective." In other words, the court resolved the dispute by resort to other contract interpretation principles, including, for example, reading the contract as a whole and avoiding an interpretation that rendered one provision superfluous.

Analysis

Minnesota joins a handful of other jurisdictions that have found that the contra proferentem doctrine does not apply to resolve ambiguities in insurance contract language in coverage disputes between two insurers. See, e.g., U.S. Fid & Guar Co. v. Heritage Mut Ins Co., 230 F.3d 331, 333 (7th Cir. 2000) (applying Indiana law); U.S. Fire Ins Co. v. Gen Reinsurance Corp., 949 F.2d 569, 573-74 (2d. Cir. 1991) (applying New York law); U.S. Fid & Guar Co. v. W Cas & Sur Co., 408 P.2d 596, 598 (Kan. 1965); Travelers Ins Co. v. Am Cas Co. of Reading, Pa., 441 P.2d 177, 180 (Mont. 1968); Boston Ins Co. v. Fawcett, 258 N.E.2d 771, 776 (Mass. 1970).

But there is a split of authority on this issue. Indeed, some have found that any ambiguities in insurance contract language will be construed against the drafter even where the dispute is between two insurers. See, e.g., Sea Ins Co. v. Westchester Fire Ins Co., 51 F.3d 22, 26 n. 4 (2d Cir. 1995) (dicta, applying New York law); Farmers Auto Ins Ass'n v. St. Paul Mercury Ins Co., 482 F.3d 976, 977-78 (7th Cir. 2007) (applying Illinois law); Twin City Fire Ins Co. v. Alfa Mut Ins Co., 817 So. 2d 687, 695 (Ala. 2001); Empire Fire & Marine Ins Co. v. Liberty Mut'l Ins Co., 699 A.2d 482, 494 (Md. Ct. Spec. App 1997) (interpreting ambiguous contract against the drafter but noting that Maryland law does not recognize contra proferentem).

Reasonable arguments can be made to support both lines of authority. On the one hand, as the Minnesota Court of Appeals noted in Economy Premier, the underlying rational for the contra proferentem doctrine — to protect the insured who is often at a disadvantage in terms of knowledge, expertise and bargaining power compared to the insurer — does not apply where the dispute is between two insurers. But on the other hand, if insurance contract language is ambiguous, it must be construed against one party and in favor of another. So some courts have recognized that it is fairer to construe the ambiguity against the drafter than against the non-drafter.

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