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Client Alert: California Supreme Court: Selecting Among Insurer-Authored Options Is Not Policy "Drafting"

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When it comes to insurance policies, it is well-established and commonly understood that the applicable rules of contract construction generally favor the policyholder over the insurance company. Indeed, the policyholder's advantage is so significant (or at least is perceived as such) that insurers routinely try to find some basis to argue that contra proferentem—the principle that ambiguities in a contract should be resolved against the drafter—and other policyholder-friendly rules of construction should not apply. One of those purported exceptions is for so-called "sophisticated insureds."

For at least the past few decades, and with increasing regularity, insurers have argued that "sophisticated insureds"—*i.e.*, large commercial policyholders with the asserted resources and ability to more fully understand the terms of their insurance policies and/or even have the ability to "negotiate" some of the language in that policy—are not entitled to benefit from policyholder-friendly rules of construction that are purportedly based solely on unequal bargaining power and asymmetric access to information. The court decisions have been mixed. While some courts have at times limited the application of contra proferentem and other policyholder-friendly construction rules, others have not, and almost all courts have been reticent to summarily displace the rules of construction that traditionally apply to insurance policies.[1]

One of the most recent courts to weigh in on the insurers' "sophisticated insured" argument is the California Supreme Court. In *Yahoo Inc. v. National Union Fire Insurance Company of Pittsburgh, Pa.*, the Court responded to a certified question, as rephrased, from the United States Court of Appeals for the Ninth Circuit.[2] At issue was Yahoo's quest for CGL insurance coverage with respect to class action lawsuits alleging that Yahoo had sent unsolicited text messages in violation of the Telephone Consumer Protection Act of 1991 (TCPA). The insurer, National Union, had declined to defend or indemnify Yahoo on the ground that the loss purportedly was excluded under the terms of each of four consecutive National Union policies covering the period May 31, 2008 to May 31, 2012. In order to help it resolve the appeal, the Ninth Circuit asked the California Supreme Court for guidance as to how Yahoo's policies should be construed in the context of TCPA claims.[3]

The specifics of the Yahoo coverage were discussed in detail by the Court. Basically, the standard policy form that National Union used for the Yahoo policies excluded injuries arising from the distribution of material in violation of the TCPA. That exclusion, however, was removed through an endorsement that also modified the standard form "personal and advertising injury" coverage common to many CGL policies.[4] More specifically, the endorsement acknowledged coverage for injuries arising from "[o]ral or written publication, in any manner, of material that violates a person's right of privacy," but expressly excluded coverage for "advertising injury," which it defined to include "[o]ral or written publication, in any manner, of material *in your 'advertisement'* that violates a person's right of privacy."[5]

The issue before the Ninth Circuit, for which it sought assistance from the California Supreme Court, was whether these adjustments to National Union's standard policy form left any room for coverage of the TCPA claims asserted against Yahoo. The California Supreme Court concluded that the language could allow for coverage, adding to pro-policyholder decisions from the highest courts in Illinois, Florida and Missouri.[6] The Court engaged in a detailed analysis of the policy language at issue and found it to be ambiguous, ultimately concluding that the "right to privacy" included the right to seclusion and that a CGL policy "can cover liability for violations of the right of seclusion if such coverage is consistent with the insured's objectively reasonable expectations."[7] The record did not address Yahoo's reasonable expectations, however, and the California Supreme Court (and later the Ninth Circuit, upon receiving the California high court's decision) noted that further proceedings at the trial court level would be necessary to determine whether the policy ambiguity could be resolved on that ground.[8]

The California Supreme Court further held that if the ambiguity could not be resolved by interpretation in a manner that fulfilled Yahoo's reasonable expectations, then the next step would be to resort to "the rule that we interpret unresolvable ambiguities in favor of the insured."[9] *Id.* The Court noted, however, that contra proferentem "does not necessarily apply where the insured is one of the contract's drafters."[10] More specifically, National Union had argued that Yahoo was a "sophisticated" party that had bargained over the terms of a "manuscript endorsement," such that the rule did not apply. The Court summarily rejected this argument, finding that "the disputed coverage language under review is standard form language adopted verbatim from insurer-drafted policies."[11] In other words, Yahoo and/or its insurance broker had (at best) simply selected from among various insurer-drafted policy provisions, and as such could not "be charged with creating the ambiguity that led to the dispute."[12]

It would be hard to argue, under any objective standard, that Yahoo is not a "sophisticated" insured with the resources to understand the insurance coverage it purchased during the 2008–2012 period. The record also showed that Yahoo had at least some ability to bargain over the terms of its coverage, as demonstrated by the endorsement at issue. But at the end of the day, those factors were not sufficient for the California Supreme Court to dispense with the rule of contra proferentem.

The Court found that the insurance industry had drafted the language that gave rise to the dispute, and the rule of contra proferentem therefore was still appropriate.[13]

The California Supreme Court's decision thus highlights what is arguably the most persuasive rationale for applying pro-policyholder construction rules to insurance policies: while some policyholders may have some ability to bargain for changes to their policy language, the fact remains that these "changes" are largely based on or derived from insurer-drafted language. In contrast to corporate merger agreements, real estate purchase agreements, and other common commercial contracts, the insurance industry depends heavily on relative uniformity of contract language. Indeed, it is this relative uniformity of language that allows the insurance industry to operate as it does—to actuarially project and analyze actual and anticipated losses and to price its insurance products accordingly. An insurance industry in which "sophisticated insureds" truly had the ability to negotiate dramatic departures from industry-drafted language and introduce significant variations in coverage from policy to policy—the type of variations necessary to truly justify a departure from contra proferentem—arguably could not function in its current form. And under those circumstances, applying the rule of contra proferentem in favor of policyholders—even so-called "sophisticated" ones—is not just logical. It is required.

Footnotes

[1] *See, e.g., Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 607 N.E.2d 1204, 1218 (Ill. 1992) ("In Illinois, ambiguities and doubts in insurance policies are resolved in favor of the insured, especially those that appear in exclusionary clauses."); *Boeing Co. v. Aetna Cas. And Sur. Co.*, 784 P.2d 507, 514 (Wash. 1990) (en banc) (although the insured was a large corporation, "[t]he critical fact remains that the policy in question is a standard form policy prepared by the company's experts, with language selected by the insurer"); *but see Oxford Realty Group Cedar v. Travelers Excess and Surplus Lines Co.*, 160 A.3d 1263, 1270–71, 73 (N.J. 2017) (finding policy terms unambiguous but observing that "[s]ophisticated commercial insureds . . . do not receive the benefit of having contractual ambiguities construed against the insurer"); *Catlin Specialty Ins. Co. v. QA Fin. Corp.*, 36 F. Supp. 3d 336, 342 (S.D.N.Y. 2014) ("Contra proferentem does not apply where contracts are negotiated by sophisticated parties of equal bargaining power.").

[2] 519 P.3d 992 (Cal. 2022).

[3] *Id.* at 995–97.

[4] *Id.*

[5] *Id.*

[6] *See Columbia Cas. Co. v. HIAR Holding, L.L.C.*, 411 S.W.3d 258 (Mo. 2013) (en banc); *Penzer v. Transp. Ins. Co.*, 29 So. 3d 1000 (Fla. 2010); *Valley Forge Ins. Co. v. Swiderski Elec., Inc.*, 860 N.E.2d 307 (Ill. 2006).

[7] *Yahoo*, 519 P. 3d 992 at 1003.

[8] *See id.* at 1001.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *See id.*

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