In California, narrow scope of policy exclusions, limitations

By Kirk Pasich

California courts long have recognized the respective burdens between and insurer and an insured as to whether a policy provides coverage for a particular claim or loss. As the state Supreme Court stated more than 20 years ago, once the insured shows that an event falls within the scope of basic coverage under the policy, the burden is on the insurer to prove a claim is specifically excluded. Garvey v. State Farm Fire & Casualty Co., 48 Cal. 3d 395, 406 (1989).

However, the burdens on the insured and the insurer differ in terms of how they may be satisfied. If policy language is ambiguous, it will be interpreted in the insured's favor. See, e.g., AIU Insurance Co. v. Superior Court, 51 Cal. 3d 807, 822 (1990) ("In the insurance context, we generally resolve ambiguities in favor of coverage."). This is true even if the insured is deemed to be a "sophisticated" party and participated in negotiating the policy language. See id. at 825 & n.9 (Even if insurers offer evidence to show that policies were written "on a line-per-line basis through continuing negotiation" by insured and that insured "unquestionably possesses both legal sophistication and substantial bargaining power," there is "little reason to depart from ordinary principles of interpretation," absent a showing that "the parties, at the time they entered into the policies, intended the provisions at issue ... to carry technical meanings and implemented this intention by specially crafting policy language").

Notwithstanding this rule, insurers often argue that exclusions in their policies should apply in many situations on a broader basis than insureds might contemplate. California courts typically reject such arguments, often by starting with the principle that exclusions or limitations must be conspicuous, plain and clear to be effective. See, e.g., Steven v. Fidelity & Casualty Co., 58 Cal. 2d 862, 877-78 (1962). "A restriction on coverage is not sufficiently conspicuous unless it is "positioned in a place and printed in a form which would attract a reader's attention." Ponder v. Blue Cross, 145 Cal. App. 3d 709, 719 (1983).

Any limitation on coverage must not only be conspicuous, but "must also be plain and clear in order to be given effect." Travelers Property Casualty Co. of America v. Superior Court, 2013 DJDAR 5005 (Cal. App. 2nd Dist. 2013). In fact, the state Supreme Court has stated that it has "declared time and again 'any exception to the performance of the basic underlying obligation must be so stated as clearly to apprise the insured of its effect.'" Haynes v. Farmers Insurance Exchange, 32 Cal. 4th 1198, 1204 (2004). "This means more than the traditional requirement that the contract terms be 'unambiguous.' Precision is not enough. Understandability is also required." Id. at 1211. Thus, an exclusion is subject to the "closest possibility scrutiny." Id. at 1212.

Therefore, "coverage exclusions and limitations are 'strictly construed against the insurer and liberally interpreted in favor of the insured.' Similarly, exceptions to exclusions are construed
broadly in favor of the insured. ... "The burden rests upon the insurer to phrase exceptions and exclusions in clear and unmistakable language." *Meraz v. Farmers Insurance Exchange*, 92 Cal. App. 4th 321, 324 (2001); see also *Manzarek v. St. Paul Fire & Marine Insurance Co.*, 519 F.3d 1025, 1032 (9th Cir. 2008) ("California law requires us to adopt a narrow construction" of an exclusion; holding that field of entertainment exclusion does not excuse insurer from duty to defend suit brought against two members of The Doors by another member for infringing trademark, name and logo).

If policy language is ambiguous, it will be interpreted in the insured's favor. ... This is true even if the insured is deemed to be a "sophisticated" party and participated in negotiating the policy language.

Additionally, in assessing the scope of an exclusion, courts consider other language available in the marketplace and elsewhere in the insurance policy. "[S]everal courts have observed an insurance company's failure to use available language to exclude certain types of liability gives rise to the inference that the parties intended not to so limit coverage." *Fireman's Fund Insurance Co. v. Atlantic Richfield Co.*, 94 Cal. App. 4th 842, 852 (2001). Thus, if an insurer chooses "not to include limiting language," then the words it uses will not "support [the insurer's] position regarding an intent to limit coverage." *Id.*

Indeed, the state Supreme Court has applied this principle in invalidating exclusions. For example, in *Safeco Insurance Co. of America v. Robert S.*, 26 Cal. 4th 758 (2001), the court addressed an exclusion for "any illegal act." The insurer argued that the exclusion should be interpreted to bar coverage only for violations of criminal law. The court rejected this argument, stating: "Had Safeco wanted to exclude criminal acts from coverage, it could have easily done so. Insurers commonly insert an exclusion for criminal acts in their liability policies. ... Because Safeco chose not to have a criminal act exclusion, instead opting for an illegal act exclusion, we cannot read into the policy what Safeco has omitted. To do so would violate the fundamental principle that in interpreting contracts, including insurance contracts, courts are not to insert what has been omitted." *Id.* at 763-64. In so holding, the court reaffirmed that policies should not be interpreted in a fashion that renders coverage illusory. *Id.* at 765.

Furthermore, when there is a dispute over the meaning of an exclusion or limitation, the insurer cannot prevail unless it demonstrates that its interpretation is the only reasonable interpretation. This principle is exemplified by the state Supreme Court's holding in *MacKinnon v. Truck Insurance Exchange*, 31 Cal. 4th 635 (2003). There, the court addressed the scope of a pollution exclusion. The insurer argued that the exclusion applied to a claim that a building tenant had died from exposure to pesticide applied at the building. The court disagreed, stating once again that insurance coverage provisions are "interpreted broadly so as to afford the greatest possible protection to the insured. [whereas] ... exclusionary clauses are interpreted narrowly against the insurer." The court explained that the rule applies "with particular force when the coverage
portion of the insurance policy would lead an insured to reasonably expect coverage for the
claim purportedly excluded." Id. at 648.

The court emphasized that "even if [an insurer's] interpretation is considered reasonable, it would
still not prevail, for in order to do so it would have to establish that its interpretation is the only
reasonable one." Id. at 655. See State Farm Mutual Automobile Insurance Co. v. Jacober, 10
Cal. 3d 193, 202-03 (1973) ("even assuming that the insurer's suggestions are reasonable
interpretations which would bar recovery by the claimants, we must nonetheless affirm the trial
court's finding of coverage so long as there is any other reasonable interpretation under which
recovery would be permitted in the instant cases"); Ticketmaster, LLC v. Illinois Union
apply to class action lawsuit regarding false representations regarding delivery fees and order-
processing charges because insurer "failed to satisfy its burden of showing that ... its
interpretation of [the exclusion] is the only reasonable one").

Therefore, in assessing coverage under a policy, it is important to consider whether all of the
requirements for the application of an exclusion or limitation on coverage are satisfied. If an
exclusion or limitation is conspicuously placed in a policy, the inquiry does not end there. If
other language is available in the marketplace that more clearly states a purported exclusion, then
the exclusion in question should not be read as if it contained that language. To be enforced, the
language must be clear and unmistakable. And, as the courts have recognized, if the language is
susceptible to more than one reasonable interpretation, then it matters not if the insurer's
interpretation is a reasonable one.

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