Are Insurance Policies Still Contracts

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Abstract

This article examines whether courts still treat insurance policies as contracts. Since the inception of insurance, policies have been deemed contracts, and general principles of contract interpretation have been used to interpret policies. However, more and more courts are abandoning contract principles when interpreting insurance policies, particularly using parol evidence to determine whether a policy provision is ambiguous, or even using parol evidence to interpret the meaning of unambiguous policy terms. My conclusion is that insurance policies, while still generally considered “contracts,” are treated differently then other contracts, and in reality are not seen as true contracts.
ARE INSURANCE POLICIES STILL CONTRACTS?

BY

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Since the earliest days of the insurance industry, insurance policies have been deemed contracts between the carrier and the insured. The interpretation of insurance policies is governed by contract principles. While insurance policies are considered contracts of adhesion, and any ambiguity is strictly construed against the drafter, a policy has always been considered a contract.

Insurance policies have always been interpreted using general contract principals of interpretation. That is, unambiguous provisions of an insurance policy are given their plain and ordinary meaning. Parol evidence is not permitted to interpret an unambiguous policy provision.

However, recent decisions in various courts have called into questions whether an insurance policy is still a contract, and whether contract rules of construction are still applicable to insurance policies. Most notably, courts are using parol evidence to determine the intent of parties, and in some cases the intent of non-parties to the insurance policy, to interpret unambiguous policy provisions. This calls into question the entire relationship between carriers and insureds, and questions whether insurance policies are still contracts.

I. GENERAL CONTRACT PRINCIPALS

Insurance policies are contracts.¹ The general rule of construction for contracts is well known and needs little discussion here. The main goal of contract interpretation is to enforce the parties’ intent. If the document is clear and unambiguous that intent is derived from the

language of the policy. Interpretation is limited to the four corners of the contract. As stated by the Court of Appeals of Michigan:

The main goal of contract interpretation generally is to enforce the parties’ intent. But when the language of a document is clear and unambiguous, interpretation is limited to the actual words used, and parole evidence is inadmissible to prove a different intent. An unambiguous contract must be enforced according to its terms. The judiciary may not rewrite contracts on the basis of discerned “reasonable expectations” of the parties because to do so is contrary to the bedrock principal of American contract law that parties are free to contract as they see fit, and the courts are to enforce the agreement as written absent some highly unusual circumstance, such as a contract in violation of law or public policy.²

While different words and phrases are used to describe this general proposition, the fundamental principle, that unambiguous contracts are interpreted pursuant to the unambiguous terms of the contract, is generally accepted.³

³ Trimbel v. Todd 510 So. 2d 810 (Ala. 1987) (“Where no ambiguity exists, the Court’s only function is to interpret the lawful meaning and intentions of the parties as found within the agreement and to give effect to them.”); Deitrich v. Deitrich 226 Cal. App. 650 (Ct. App. 1964) (“the accepted rule that as between parties who have reduced their agreements to writing, the courts may not rewrite such agreements contrary to the intention of the parties expressed therein.”) (emphasis in original); Garcia v. Tarmac American Inc. 880 So. 2d 807 (Fla 2004) (“In reviewing the trial court’s construction, the appellate court is guided first by the language of the contract itself and when the contract is clear and unambiguous there is no reason to go further. In such a situation, the intent of the parties must be determined from only the four corners of the document, and not parol evidence.”); Bilow v. Preco, Inc. 132 Idaho 23 (1998) (“If the contract is clear and unambiguous, the court give effect to the language employed according to its ordinary meaning. In construing unambiguous terms of a contract, the court ascertains the parties' intent from the language contained in the contract”); Bituminous Cas. Corp. v. Sand Livestock Systems, Inc., 728 N.W.2d 216 (Iowa 2007) (“The cardinal principle in the construction and interpretation of insurance policies is that the intent of the parties at the time the policy was sold must control. Except in cases of ambiguity, the intent of the parties is determined by the language of the policy.”); Ary Jewelers, LLC v. Krigel 277 Kan. 27 (2003) (“The cardinal rule in contract interpretation is to ascertain the intention of the parties and to gives effect to that intention. Unless a contract is ambiguous, the intent of the parties is determined based on the contract alone, not on extrinsic or parol evidence”); Fontenot v. Diamond B Marine Services, Inc. 937 So. 2d 425 (La. 2006) (“To ascertain the common intent of the parties, one must look at the language of the insurance policy. The meaning and intent of the parties to the written contract must be sought within the four corners of the instrument and cannot be explained or contradicted by parol evidence”); Care Center of Kansas City v. Horton 173 S.W 3d 353 (Mo. 2005) (“The cardinal rule of contract interpretation is to ascertain the parties’ intention and to give effect to that intention. Intent is to be determined from the contract alone and not based on extrinsic or parol evidence unless the contract is ambiguous.”); Thomas Rigging & Construction Company, Inc. v. Contraves, Inc.978 A.2d 753 (Sup. Ct. Pa. 2002) (“The intent of the parties is to be ascertained from the document itself when the terms are clear and unambiguous.”); Centerpoint Energy Houston Electric, LLP v. The Old TJC Company 177 S.W. 3d 425 (Texas, 2005) (“To determine the parties’ intent, extrinsic evidence is admissible only when an ambiguity appears on the face of the deed, in a suit for
Recent cases decided by the New York Appellate Division clearly annunciate the standard when dealing with unambiguous contracts. The most recent case, *Trio Asbestos Removal Corp. v. Marinelli* put it in simple and plain language: “It is axiomatic that a contract is to be interpreted so as to give effect to the intention of the parties as expressed in the unequivocal language employed.” (citations omitted). Another court noted: “Whether a contract is ambiguous is a question of law for the court and is to be determined by looking within the four corners of the document….The intent of the parties must be found within the four corners of the contract, giving a practical interpretation to the language employed and the parties’ reasonable expectation.”

In interpreting an unambiguous contract provision, it is not proper to use parole evidence concerning the intent of the parties. The intent of the parties should be discerned from the language of the policy itself. “The cardinal rule in contract interpretation is to ascertain the intention of the parties and give effect to that intention. Unless the contract is ambiguous, the intent of the parties is determined based on the contract alone, not extrinsic or parol evidence.

The use of extrinsic or parol evidence is improper in construing unambiguous contracts. This remains the majority rule. As stated in the Supreme Court of Alabama:

Where no ambiguity exists, the Court’s only function is to interpret the

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4 37 A.D.3d 475 (2d Dept. 2007).
5 Id. at 476.
8 Bilow v. Presco, Inc. 132 Idaho 23 (1998) (“Therefore, unless the employment agreement is ambiguous, it is improper to consider extrinsic evidence”).
lawful meaning and intentions of the parties as found within the agreement and to give effect to them. Parol evidence is not permitted to explain unequivocal terms. ⁹

The general rule of contract law is that the contract speaks for itself. The terms and conditions of the contract, if unambiguous, express the intent of the parties. All conversations and agreements between the parties are merged to the agreement. The Supreme Court of Wyoming describes the general rules of contract interpretation:

Our rules of contract of construction are well known. First, we do not need to construe contracts that are not ambiguous. Whether a contract is ambiguous is a question of law. When deciding whether a contract is ambiguous, we endeavor to determine the intention of the parties. An ambiguity exists when a contract’s language conveys an obscure or double meaning. When contract provisions are not ambiguous or uncertain, the document speaks for itself. With an unambiguous agreement, we secure the parties’ intent from the words of the agreement as they are expressed within the four corners of the document. All conversations, contemporaneous negotiations, and parol agreements between the parties that occurred prior to the written agreement are merged into the written agreement. We turn to extrinsic evidence and rules of contract construction only when the contract language is ambiguous and its meaning is doubtful or uncertain. ¹⁰

Many years ago the New York Court of Appeals set forth the standard in interpreting insurance policies:

Contracts of insurance, like other contracts, are to be considered according to the sense and meaning of the terms, which the parties have used, and if they are clear and unambiguous, the terms are to be taken and understood in their plain, ordinary and proper sense. ¹¹

An unambiguous policy provision should be enforced, as the words of the policy convey

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¹⁰ Rehnberg v. Hirschberg 64 P.3d 115, 118 (Wy. 2003) (citations omitted). See also, Burkhardt v. Bailey, 260 Mich. App. 636, 656-657 (2004) (“The main goal of contract interpretation generally is to enforce the parties’ intent. But when the language of a document is clear and unambiguous, interpretation is limited to the actual words used, and parol evidence is inadmissible to prove a different intent.”) (citations omitted).
¹¹ Johnson v. Travelers Ins. Co., 269 NY at 408.
the intent of the parties. Regarding insurance policies, this is the insured and the carrier. Parol evidence should not be permitted to interpret the parties’ intent absent an ambiguity.

However, several jurisdictions are using parol evidence to interpret unambiguous provisions of insurance policies. Indeed, these courts concede that the policy is unambiguous, but use parol evidence in order to arrive at an outcome not necessarily warranted by the express terms and provisions of a policy.

Some courts are using agreements between the insured and a third party to change an unambiguous provision of the insurance policy. Thus, they are not merely using agreements between the parties to a contract (the insured and carrier), but agreements with a non-party (the insured and a third-party). This goes against the fundamental rules of contract interpretation.

II. INSURANCE POLICIES AS CONTRACTS

We start out with the fundamental proposition that insurance policies are contracts.\(^{12}\) More than 70 years ago, the New York Court of Appeals put it succinctly: “Contracts of insurance, like other contracts, ought to be construed according to the sense and meaning of the terms which the parties have used, and if they are clear and unambiguous, the terms are to be taken and understood in their plain, ordinary and proper sense.”\(^{13}\)

As with other contracts, the rules of contract construction as outlined above generally apply to insurance policies. Again, the New York Court of Appeals has stated:

In determining a dispute over insurance coverage, we first look to the language of the policy. We construe the policy in a way that affords a fair meaning to all the language employed by the parties in the contract and leaves no provision without force and effect. We will not disregard clear provisions, which the insureds inserted in the policies and the insured accepted, an equitable considerations will not allow an extension of

\(^{12}\) See, Johnson v. Travelers.

\(^{13}\) Id. at 408.
coverage beyond its fair intent and meaning in order to obviate objections which might have been foreseen and guarded against.\textsuperscript{14}

The general rule of construction is that unambiguous policy provisions should be enforced. Thus, external evidence, such as that of practical construction, may only be referenced where the policy provisions are ambiguous.\textsuperscript{15}

A contract of insurance is no different from any other contract and must be construed in a fair and reasonable manner giving regard to the risk, subject matter, and the purpose of the policy.\textsuperscript{16} Courts cannot “import terms into insurance contracts” or “rewrite policies so as to cover risks not assumed.”\textsuperscript{17} This is the rule in a majority of jurisdictions.\textsuperscript{18}

\textbf{III. THE TIDE BEGINS TO TURN}

One the first indications that the tide may be turning against the interpretation of insurance policies as contracts can be seen in \textit{Darner Motor Sales, Inc. v. Universal Underwriters Insurance Company}.\textsuperscript{19} In \textit{Darner Motor Sales}, the Supreme Court of Arizona reversed a decision of the Arizona Court of Appeals, and held questions of fact existed as to what the language of the insurance policy meant. The court held that questions of fact existed as to whether the limitations contained in the policy are applicable, or whether the insured’s “understanding” of what he thought the limitations were should prevail.

\begin{itemize}
\item \textsuperscript{15} \textit{Id.}: \textit{Continental Casualty Co. v. Rapid-American Corporation}, 80 N.Y. 2d 640, 651 (1993).
\item \textsuperscript{17} \textit{National Life & Accident Ins. Co. v. Meritt}, 200 Ark. 158. (1940).
\item \textsuperscript{19} 140 Ariz 383 (1984).
\end{itemize}
In *Darner Motor Sales*, plaintiff had a policy through defendant’s insurance company covering cars that it owned. The coverage limits were $100,000/$300,000 for the insured, and lessees were covered with limits of $15,000/$30,000. The policy was renewed with the same coverage limits. The deposition testimony indicated that the insurance agent for the defendant insurance company told plaintiff not to worry about the limits because the all risk clause of the umbrella policy would provide additional coverage to the limits of $100,000/$300,000. This was denied by the agent.

The policy of insurance provided that the coverage extended to lessees was $15,000/$30,000. Plaintiff never read the insurance policy. Plaintiff testified that, in essence, the policy was too thick and was “like reading a book.” The court pointed out that the “boiler plate provision” contained in the small-type “book length” all risk policy was not negotiated before the policy was issued. Conspicuously absent from the court’s opinion was whether the reduced insurance coverage for lessees was contained in the “boilerplate” provisions or whether it was contained in the declaration page independent of the body of the policy.

During the policy period, a lessee of plaintiff’s business had an accident causing severe injuries. Plaintiff recovered $60,000 in the underlying action, of which the insurer, Universal, paid $15,000. Plaintiff, the insured, brought action against Universal, alleging that: Universal be estopped from denying coverage in the amounts less than $100,000/$300,000 based upon the statements of its agent; the policy should be reformed so that it would contain the believed coverage; plaintiff’s loss was caused by a negligence of the carrier and its agent; and there was fraud committed by the insurer’s agent. The court permitted all four counts to go to trial, holding that questions of fact existed despite the admittedly unambiguous policy language.

The court put the question as follows: “Whether the court will enforce an unambiguous
provision contrary to the negotiated agreement made by the parties because, after the insurer’s representation of coverage, the insured failed to read the insurance contract which was in his possession.” While the court noted that the existing law was that an oral agreement between a carrier and the insured could not vary the terms of insurance policy, and that the court could not rewrite a policy, the court argued that this new method of policy interruption was actually only a different “articulation” of established rules.

The court examined various treatises, including *Corbin on Contracts* and *Restatement (Second) of Contracts*. Specifically, the court accepted the doctrine regarding reasonable expectations, but recognized the reasonable expectation doctrine is problematic.

Of course, if not put in proper perspective, the reasonable expectations concept is quite troublesome, since most insureds develop a “reasonable expectation” that every loss will be covered by their policy. Therefore, the reasonable expectation concept must be limited by something more than the fervent hope usually engendered by loss. Such a limitation is easily found in the postulate contained in Corbin’s work—that the expectations to be realized are those that “have been induced by the making of a promise.”

The court then analyzed how to deduce the reasonable expectations. The court adopted the reasoning of the *Restatement (Second) of Contracts* regarding the use of extrinsic evidence. “The Restatement approach is basically a modification of the parol evidence rule when dealing with contracts containing boiler-plate provisions which are not negotiated, and often not used by the parties.” The court relied upon the comment to Subsection (3) of section 211 of the Restatement:

> Although customers typically adhere to standardized agreements and are bound by them without even appearing to know the standardized terms in

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20 *Id* at 392.
21 *Id*.
22 *Id.* at 390, citing Corbin, *Contracts Section 1* at 2.
23 *Id.* at 396.
detail, they are not bound to unknown terms which are beyond a range of reasonable expectation…[insured] who adheres to the [insurer’s] standard terms does not assent to the terms if the [insurer] has a reason to believe that the [insured] would not have accepted the agreement if he had known that the agreement contained the particular term. Such a belief or assumption may be shown by the prior negotiations are inferred from the circumstances. Reason to believe may be inferred from the fact that the terms is bizarre or oppressive, from the fact that it eviscerates the non-standard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction. The influence is reinforced if the adhering party never had the opportunity to read the term, or if it is illegible or otherwise hidden from view. This rule is closely related to the policy against unconscionable terms and the rule of interpretation against the draftsman.24

The court, however, did not analyze whether the separate limits of coverage provided to lessees were “unknown terms which are beyond the range of reasonable expectation,” whether the terms were “bizarre or oppressive,” whether the specific term was part of the standardized agreement, or whether the insured had the opportunity to read the terms.

The court noted that the “boilerplate” definition of the word “insured,” excluding lessees, was not bargained for, written by or read by the insured.25 Thus, the court was free to abandon the common ordinary definition of “insured” that was contained in the policy. The court noted that, if it was determined that the insured and the agent agreed upon lessee’s coverage limits of $100,000/$300,000, the carrier would be estopped to assert an exclusion that eliminates the insured’s lessee from the class of normal insureds. Id.

The court continued by stating that the insured is entitled to reformation of the policy despite the clear terms. The court also stated that negligence of the carrier’s agent was a question of fact to be decided by a jury.

Thus, the Supreme Court of Arizona essentially abandoned the rules of construction for

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24 Id. at 390-391.
25 The court did not address whether the insured could have buy and far additional coverage, or could have read the policy.
contracts when dealing with insurance policies. Express terms and provisions are no longer binding, as long as the insured could argue that he believed that the unambiguous terms meant something other than the plain meaning.

Chief Justice Holohan issued a strongly worded descent. Justice Holohan noted that the court “proceeds to adopt virtually every minority position taken by any court or text writer in the United States. The decision makes the contents of a written insurance policy irrelevant in the determination of the nature and extent of coverage. In place of the insurance policy the nature and extent of coverage will now be decided by a swearing contest between the insured and the insurance company’s agents.” Justice Holohan noted the potential ramifications of the court’s decision.

The mischief created by today’s decision would be far-reaching. Currently the only industry affected is the insurance industry. It can be said without any exaggeration that no insurance company now operating in Arizona can be assured that the written policies currently in effect have the limitations contained in the policy. The extent of the risk which these companies thought they had undertaken is now incapable of calculation. The extent of the risk is limited only by the impressions or the imagination of policyholders about the extent of their coverage.

New Jersey is another state that has essentially abandoned the rules of construction of contracts when dealing with insurance policies. In 1998, the Supreme Court of New Jersey, in *Werner Industries, Inc. v. First State Insurance Company*, held:

The fundamental principle of insurance law is to fulfill the objectively reasonable expectations of the parties. Nevertheless, the recognition that insurance policies are not readily understood has compelled courts to resolve ambiguities in such contracts against the insurance company. At times, even an unambiguous contract has been interpreted contrary to its plain meaning so as to fulfill the reasonable expectation of the insured:

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26 *Id.* at 401 (Holohan, CJ dissenting).
27 *Id.*
The interpretation of insurance contracts to accord with the reasonable expectations of the insured, regardless of the existence of any ambiguity in the policy, constitutes judicial recognition of the unique nature of contracts of insurance. By traditional standards of contract law, the consent of both parties, based on an informed understanding of the terms and conditions of the contract, is rarely present in insurance contracts. W.D. Slawson, “Standard Form Contracts and Democratic Control of Lawmaking Power”, 84 Harv. L. Rev. 529, 539-41 (1971); R. Keeton Insurance Law, 350-352 (1971). Because understanding is lacking, the consent necessary to sustain traditional contracts cannot be presumed to exist in most contracts of insurance. Such consent can be referred only to the extent that the policy language conforms to public expectations and commercially reasonable standards.\(^{29}\)

Simply put, insurance policies are not true contracts.

The main thrust of the *Werner* decision was the adoption of the “reasonable expectation” standard, regardless of an ambiguity. This standard used in other New Jersey decisions. For example, in *Voorhees v. Preferred Mutual Insurance Company*,\(^{30}\) the Supreme Court adopted the *Werner* standard that the reasonable expectations outweigh the plain language of a policy. The court held that the phrase “bodily injury” was ambiguous as involving purely emotional distress claims. Likewise, the court held the term “occurrence” was ambiguous regarding intentional actions.

In *Gibson v. Callaghan*,\(^{31}\) the New Jersey Supreme Court adopted the notion that “even an unambiguous contract has been interpreted contrary to its plain meaning so as to fulfill the reasonable expectations of the insured.”\(^{32}\)

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\(^{29}\) *Id.* at 190-191 (case citation omitted). In *Werner*, the New Jersey Supreme Court reversed the Appellate Division, and reinstated the Trail Court’s decision denying the insured’s claims for insurance under an umbrella policy. The court held that the terms of the umbrella policy were plain, and the terms were not inconsistent with public expectations.


\(^{32}\) *Id.* at 1283.
In *Fortunato v. Highland Ins. Group*\(^{33}\), the court stated the law in interpreting insurance contracts as follows:

The parties to an insurance policy do not have equal bargaining power. Thus, in order to render a fair interpretation of the boundaries of insurance coverage, the courts will enforce only the restrictions and the terms in an insurance contract that are consistent with the objectively reasonable expectations of the average insured.\(^{34}\)

The court noted that insureds are entitled to “the broad measure of protection necessary to fulfill their reasonable expectations” and insureds should not be subject to “technical encumbrances.” A policy should be construed liberally in favor of the insured “to the full extent that any fair interpretation will be allowed.”\(^{35}\)

In *Fortunato*, the court analyzed whether an umbrella policy provided coverage to a husband after his wife slipped and fell on snow and ice. The wife sued the husband claiming negligence in failing to remove the snow and ice outside their mutual house. The wife was awarded judgment of $350,000, and the husband tried to collect under his umbrella policy. The court noted that the homeowner’s policy contained a mutual insured exclusion, but the umbrella policy did not. The umbrella policy merely stated that it only covered bodily injury to “others” caused by an accident.

Incredibly, the court for *Fortunato* granted summary judgment to the insured, holding that the reasonable expectations of the insured was that coverage would be provided under the umbrella policy. However, the court did not cite to any facts regarding what were the husband’s reasonable expectations. The court merely stated that the policy provided coverage because that was the reasonable expectations.

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\(^{34}\) *Id.* at 532 (citations omitted).
\(^{35}\) *Id.* (citations omitted).
New Jersey law, like Arizona, holds, in essence, that no policy provision is definitely known. Even such basic terms as the amount of coverage can be changed if the insured can convince the court that they believed more coverage was afforded. For example, in Weinisch v. Sawyer\(^{36}\), the court reformed the policy based upon the negligence of an agent. Thus, the policy’s limit of insurance was not binding, despite the fact that the insured was given a copy of the policy prior to the accident. This was a similar result as in Darner Motor Sales, wherein the Supreme Court of Arizona permitted the amount of insurance coverage to go to the jury.

Thus, insurers in Arizona and New Jersey cannot rely upon any terms in a policy of insurance. Indeed, in New Jersey, it is not even necessary for an insured to read a policy of insurance.\(^{37}\) Thus, years after an insurance policy has been issued and terminated, an insurer can face a situation where none of the policy terms and conditions, i.e., the amount of coverage, the terms of coverage, or any exclusion, are necessarily to be enforced. Indeed, even basic terms and exclusions such as the employer exclusion, intentional acts exclusion, or notice provisions, may not be enforced because the “reasonable expectations” of the insured are different. The plain unambiguous policy language may simply be rejected to provide more coverage than bargained for.

### IV. OTHER CASES

Some jurisdictions have followed Arizona and New Jersey regarding the interpretation of insurance policy, although to varying extents. While most courts still use at least some traditional contract analysis in interpreting insurance policies, some courts do use extrinsic evidence to determine the intent of the parties. In Whittier Properties v. Alaska Natiojal Ins.


and Nelson v. Progressive Cas. Ins. Co. the Alaska Supreme Court reiterated the proposition that “relevant” extrinsic evidence should be used when interpreting insurance contracts. California has gone further, holding that extrinsic evidence can be used to find an ambiguity. The court in Employers Reinsurance began by noting that insurance policies are “still contracts” to which ordinary contract rules apply, specifically that the mutual intention of the parties at the time of contract governs. While the court stated that the intention of the parties was to be ascertained solely from the words of the contract, “if possible,” the court went on to explain that the court will also consider “the circumstances under which the contract was made and the matter to which it relates.” Extrinsic evidence is admissible not only to explain an ambiguity, but to prove the meaning of unambiguous terms. If this seems counterintuitive, it is.

The problem is that using extrinsic evidence to establish that the plain meaning of a term is not, in fact, its meaning creates uncertainty in contracts. The primary basis of contract law is to provide certainty to the contracting parties. Court decisions eliminating this certainty do not aid insureds or insurers. Neither party can be sure express, plain terms will be enforced. If either party can convince the fact-finder that the intent was something other than the plain terms, these plain terms will be ignored. This is the opposite of certainty.

In addition, some courts have used extrinsic evidence to interpret unambiguous policies in an effort to short-cut litigation involving other contracts where the insured is a party.

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38 185 P.3d 84 (Alaska 2008)
41 Id. at 919.
42 Id.
43 While some courts state that the interpretation of policies using extrinsic evidence is a matter of law (See Nelson, supra, such interpretation necessarily involves determination of factual disputes regarding the extrinsic evidence, questions of credibility, etc.
particularly the application of the “other insurance” clauses when combined with indemnification clauses in separate contracts involving the insured. This issue has been topic in a series of decisions in the United States Court of Appeals.

These issues frequently arise in construction litigation. A subcontractor names the owner and/or general contractor as an additional insured, and the subcontractor is required to indemnify the owner and/or general contractor. The interplay between the indemnity requirement and the additional insured status is the primary source of conflict. While the owner/general contractor is an additional insured under the subcontractor’s policy, the owner/general contractor is also entitled to indemnity from the subcontractor. Additional insured status is controlled by the “other insured” clauses contained in the subcontractor’s policy and the owner/general contractor’s policy: Indemnity is not. The owner/general contractor’s insurer often brings action against the subcontractor’s carrier under both the additional insured provision and indemnity clause. Often, the insured and additional insured are not parties to the suit.

The Eighth Circuit Court of Appeals, in Wal-Mart Stores, Inc. v. RLI Insurance Company, interpreted two other insurance clauses involving vendors and retailers. The court held that when an underlying contract between two insureds has an indemnification provision, “other insurance” clauses contained in the two policies are not applicable, despite the express, unambiguous terms of the policies.

Wal-Mart dealt with a vendor endorsement to a policy issued to a supplier. The court used parol evidence to interpret “the intent of the parties” regarding both the policy and contract. The court determined that the indemnification provision in the underlying contracts trumped the

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44 292 F.3d 583 (8 Cir. 2002), the hearing and rehearing on banks denied (2002).
45 The Vendor is often required to name the retailer as an additional insured, and to indemnify the retailer. These are the issues on Wal-Mart Stores.
“other insurance” provisions in the policies. Since the supplier would have had to indemnify Wal-Mart anyway, it saved judicial resources to simply ignore the issue of coinsurance.

The court relied upon *Couch on Insurance* in determining the interaction between the other insurance clauses in the policies and the indemnification agreement. The court noted that there were many cases holding that indemnity agreements determine the allocation of liability in an insurance dispute. The court noted that a leading commentator summarized this situation by observing that “an indemnity agreement between the insureds or a contract with an indemnification clause…may shift an entire loss to a particular insurer not-withstanding the existence of an other insurance clause in the policy.”

A detailed analysis of the *Wal-Mart* decision demonstrates that the *Wal-Mart* court was using extrinsic evidence, the contract between Wal-Mart and RLI’s insured, in order to interpret an unambiguous clause contained in the RLI policy. The only basis for this reasoning appears to be that it simplified the end result. In essence, if Wal-Mart’s carrier had paid half of the loss due to the coinsurance provisions, Wal-Mart’s carrier could have proceeded against RLI’s insured for that portion of the loss. RLI would then have to have had to cover that portion of the loss, presuming such contractual indemnification was covered by the RLI policy.

Significantly, there is no discussion about potential exclusions contained in the policy. Thus, we have a non-party to the insurance contract, Wal-Mart, arguing policy provisions contained in a policy where RLI’s insured, Cheyenne, is not a party in the suit. The court was trying to determine the “intent” of the parties to the underlying contract where a party involved in the underlying contract, Cheyenne, was not even in the case. This is a slippery slope regarding the interpretation of insurance policies in general.

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The *Wal-Mart* decision has been relied upon by a number of other Federal Courts of Appeals, including the Fifth Circuit in *American Indemnity v. Travelers Property & Casualty Insurance Company*[^47], and the Fourth Circuit in *St. Paul Marine Insurance Company v. The American International Specialty Lines Ins. Co.*[^48] The *Wal-Mart* court concluded as follows:

> We think this potential circuitry of action is significant, in that it reveals a true nature of the parties’ obligations and relationships with each other. RLI will ultimately be liable for the $10 Million because of Cheyenne’s promise to indemnify Wal-Mart and RLI’s contractual-liability coverage in its policy covering Cheyenne. To prevent such wasteful litigation and to give effect to the indemnification agreement between the parties, we hold that RLI cannot recover against National Union or Wal-Mart.^[49]

In the Fifth Circuit case, *American Indemnity*, Elite Masonry entered into a contract with Caddell Construction Company, wherein Elite agreed to indemnify Caddell against claims arising out of the work covered by the subcontract. Elite was a named insured under a Commercial General Liability policy issued by AIL. Caddell was an additional insured under the AIL policy. Caddell was also a named insured under a policy issued by Aetna Casualty & Surety Company.[^50] In this case, the policy did provide coverage for indemnity provisions contained in contracts.

The Fifth Circuit, adopting the *Wal-Mart* rationale, held that the indemnification provisions trumped the “other insurance” clauses contained in the respective policies. In particular, the *American Indemnity* court relied upon the “circuitry of action” quote noted above.

Significantly, *American Indemnity* ignored potential problems with the indemnity provisions. The indemnity provision in the Aetna policy indicated that it would not be

[^47]: 335 F.3d 429, (4th Cir. 2003).
[^48]: 365 F. 3d 263 (4th Cir. 2004).
[^49]: *Wal-Mart* at 594-595.
[^50]: Travelers succeeded to all of Aetna’s rights and obligation when it purchased some of Aetna’s lines of insurances. *Id.* at 432.
enforceable if the injuries were solely of the result of the negligence of Caddell. However, the
court held that since there were no findings that injuries were the sole result of the negligence of
Caddell, the indemnity provision were enforceable. Thus, in the case between two insurance
companies, the court determined the relative faults of underlying parties where none of the
parties to the underlying contract, and thus the responsible parties to the underlying plaintiff,
were present. In the interest of judicial economy, the court abandoned the long held principle
regarding interpretation of insurance policies.

The Fourth Circuit also adopted the Wal-Mart reasoning in St. Paul Fire & Marine
Insurance Company. Again, the court was more concerned with the intention and relationship of
the parties to the underlying contract, neither of which were in the case. The court ignored the
fact that the insureds were not the parties to the action. The court permitted third-parties to
change the express, unambiguous terms of a contract by an independent agreement. There was
no discussion as to whether the insurers were aware of the underlying contract with the
indemnification provision, or whether the carrier would have modified its policy or change its
premium. The court was more concerned with the convenience of the court rather than adhering
to longstanding principles.

Another panel of the Fourth Circuit took a different approach, Travelers Property &
Casualty Company of American v. Liberty Mutual Insurance Company.51 In Travelers, the
underlying plaintiff fell down a damaged stairwell in a residential duplex owned by State Street
Bank. The underlying plaintiff filed suit in California State court against the Bank and Ryland,
the managing agent of the property. Ryland commenced action against both Travelers, its
insurer, and Liberty Mutual, State Street’s insurer, to provide a defense to the underlying action.

51 444 F. 3d 217 (4th Cir. 2006).
Travelers agreed to defend, and filed a cross claim against Liberty Mutual for contribution. Travelers claimed that Ryland was an additional insured under the Liberty Mutual’s policy issued to State Street.

The District Court entered judgment in favor of Liberty Mutual, concluding that Ryland was not an additional insured under Liberty Mutual’s policy. The court also concluded that because the management agreement between Ryland and State Street provided Ryland would indemnify State Street for liability arising from Ryland’s activities, State Street had not undertaken any obligation to insure Ryland’s actions, and thus Liberty Mutual would have no indemnification responsibilities to Ryland.\(^\text{52}\)

The Fourth Circuit concluded that Ryland, as real estate manager, was an additional insured under the terms of the Liberty Mutual policy. The Court specifically rejected the District Court’s conclusion that the contract between Ryland and State Street abrogated Liberty Mutual’s independent contractual obligation to provide coverage to Ryland.\(^\text{53}\)

The Court distinguished its prior ruling in \textit{St. Paul Fire & Marine Insurance Company v. American International Specialty Lines Insurance Company}, supra, and noted that Liberty Mutual, relying upon \textit{St. Paul Fire}, argued that allowing Ryland to recover would result in circulative litigation, since Liberty Mutual could then seek recovery from Ryland based upon a subrogation claim arising from Ryland’s agreement to indemnify State Street. Thus, Liberty Mutual argued, Travelers, as Ryland’s insurer, would be obligated to pay for the cost of the underlying action.

The \textit{Travelers} court distinguished \textit{St. Paul Fire & Marine}:

\(^{52}\text{Id.}\)
\(^{53}\text{Id. at 219.}\)
Liberty Mutual’s argument, however, conflates its obligation to insure Ryland directly and its separate obligation to insure State Street. This conflation fails to account for the fact that Liberty Mutual has an independent obligation to insure Ryland as an additional insured, regardless of State Street’s liability. Liberty Mutual argues that this blurring of insurance contracts in the underlying indemnity agreement is justified by our decision in *St. Paul Fire & Marine Insurance v. American International Specialty Lines Insurance Company*, 365 Fed.3rd 263 (4th circuit 2004).54

The Court continued by noting that the only issue was coverage for Ryland’s liability. As Travelers insured Ryland, and because of Liberty Mutual’s insuring language, it also insured Ryland through its additional insured clause, “[t]he fact that Ryland agreed to indemnify State Street under the Pooling Agreement does not absolve Liberty Mutual of its independent contractual obligation to insure Ryland as State Street’s “real estate manager.””55 The Court then noted some of the pitfalls that may result from short-cutting the interpretation and application of contracts:

If the issue on this case turned on the underlying liability as between Ryland and State Street, we would likely conclude, as Liberty Mutual urges, that Ryland bore full responsibility because of its indemnification agreement. But even then, having determined that Ryland had legal responsibility for Steve Fallen’s injuries, we would still have to determine who insured that liability. In this case, Travelers concededly provided coverage, as it issued a policy directly to Ryland as a named insured. But Liberty Mutual, which issued a policy to State Street as its named insured, also provided coverage to additional insureds, not because of any indemnity clause running in favor of the insured State Street, but because of its independent undertaking to Ryland.

Thus, because we are deciding coverage for only Ryland’s liability to Steve Fallen, the indemnification agreement is irrelevant. Once Ryland’s liability is determined, as *St. Paul* instructs, we then look to the insurance policies for coverage of the liability. In this case, both Travelers and Liberty Mutual issued policies that covered Ryland, and accordingly they must share the cost of its defense.56

55 *Id.* at 224-225.
56 *Id.* at 225.
While the *Travelers* Court could have taken a short cut, as the other cases before it, and merely determine that Travelers owed complete coverage, the Court properly examined the contracts that were actually before it, the policies of insurance. The policies of insurance were clear and unambiguous, and the court interpreted them as such. The Court did not use parol evidence regarding contracts between non-parties to the case in an effort to determine how those non-parties may have wished to divide liability. Although at times this may result in circular litigation, often a dispute between two insurance companies is not the proper forum to determine potential liability of the underlying insureds.

The courts analyzing these indemnity and insurance provisions gloss over potential problems to indemnification. For example, some states restrict indemnification if the indemnitee is partially negligent. Also, some states, such as New York,\(^5\) limit the scope of indemnification clauses. There may be a specific policy provision limiting coverage for insured contracts. Finally, the anti-subrogation rule may limit an insurer’s ability to seek indemnification. While a court can certainly examine these in determining potential liability, the *Wal-Mart* case and its prodigy contain broad holdings regarding indemnification and insurance provisions. This analysis, that indemnification clauses in parol contracts to the insurance policies can essentially trump clear and unambiguous clauses in insurance policies, is simply a matter of a court’s determining that insurance policies are not true contracts entitled to all protections of contract law. The language in the *Wal-Mart* case regarding the intent of the parties is an attempt to divine the intent of non-parties to the litigation, that of the insured and an additional insured. It does not try to determine the intent of the insured and it’s the insurance company. Thus, these courts are

\(^5\) See GOL 5-322.1.
not trying to determine the intent of the parties to the contract at issue, but the intent of parties to a separate, independent contract. This is merely another step down the road of treating insurance policies as non-contracts.

V. CONCLUSION

While most courts still treat insurance policies as contracts in most respects, a number of courts are leaning towards interpreting insurance policies in a way most convenient for the judiciary, and in such a way so the insurance company for the party that is “at fault” in the minds of the judges would have to pay. The question is whether the situation is as bleak as envisioned by Chief Justice Holohan in Darner Motor Sales, supra. As Justice Holohan emphasized:

It can be said without any exaggeration that no insurance company now operating in Arizona can be assured that the written policies currently in effect have the limitations contained in the policy. The extent of the risk, which these companies thought they had undertaken is now incapable of calculation. The extent of the risk is limited only by the impressions or imagination of policyholders about the extent of their coverage.

Every insurance company in this state must review its current method of operation because today’s decision will significantly affect current policies and future policies written in this state.\(^{58}\)

Currently, insurance companies have no assurances that the terms and conditions of a policy will be enforced. Certainly, the “other insurance” provision is at the mercy of a contract the insured may enter into, unknown to the insurance company. In addition, as shown in the cases cited above, even the limits of insurance may not be enforced. Thus, insurance companies cannot be assured that the extent of the risk it insured, even if in plain and unambiguous language, will be enforced. While we recognize the great interest the courts have in ensuring injured plaintiffs obtain recovery, completely aggregating the rule of contract law in interpreting

\(^{58}\) 140 Ariz. at 401 (Holohan, CJ, dissenting).
insurance policies will only lead to problems with the insurance industry, leaving more and more plaintiffs without coverage.

Justice Holohan noted the evolution of interpretation of insurance contracts:

Under today’s decision, it appears that we have come full circle in development of the law on contracts. Oral contracts were largely the method used in early times. To avoid the disputes, which arose out of misunderstandings and oral agreements, the written contract became preferred. In modern commercial practice, the written contract is not only preferred, it is essential. It is designed to eliminate disputes, and it is intended to establish some certitude in setting out the agreement of the parties. These concepts may be basic, but they are largely ignored in today’s decision because an insured is not allowed to help write the contract. A debtor doesn’t write the mortgage or deed of trust or most any other type of financing document, but until now, the signing of the document bond the borrower to the terms of the agreement.

Whatever evil the majority is attempting to eliminate, the remedy advanced is like decapitation to cure dandruff—a cure that is far worse than a disease.\footnote{Id. at 402 (Holohan, CJ, dissenting).}

While as of yet, the dire consequences envisioned by Chief Justice Holohan have not come to pass, there is certainly nothing preventing those consequences based upon the noted cases. These cases use broad strokes to explain how the court is justified in rejecting unambiguous policy provision in favor of parol evidence in a limited number of circumstances. However, these broad strokes can be used in disputes involving any term of an insurance policy, i.e. the limits of insurance, the specific coverages, or even the amount of premium. In essence, many courts have simply abandoned any notion that an insurance policy is still a contract.