New Jersey Law Journal
STATEWIDE LEGAL AUTHORITY SINCE 1878
An ALM Publication
MONDAY, AUGUST 14, 2017 NJLAWJOURNAL.COM

Chipping Away at the Insurance Bedrock

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The bedrock principle of New Jersey insurance coverage law is that the insurance policy is an adhesion contract drafted solely by the insurance industry. As our Supreme Court stated more than 50 years ago:

> Insurance contracts are unipartite in character. They are prepared by the company's experts, men learned in the law of insurance who serve its interest in exercising their draftsmanship art. The result of their effort is given to the insured in printed form upon the payment of his premium. The circumstances long ago fathered the principle that doubts as to the existence of coverage must be resolved in favor of the insured.

Kievit v. Loyal Protective Life Insurance Co., 34 N.J. 475 (1961). See also, Voorhees v. Preferred Mutual Insurance Co., 128 N.J. 165 (1992) ("But because insurance policies are adhesion contracts, courts must assume a particularly vigilant role in ensuring their conformity to public policy and principles of fairness.").

This principle has been reiterated time and time again by the Supreme Court since 1961 as the court established the structure of modern New Jersey insurance law. This principle lies at the base of New Jersey's rules of insurance policy interpretation: courts give terms in an insurance policy their ordinary meaning; interpret ambiguities in favor of coverage; construe exclusions narrowly; and respect the objectively reasonable expectations of policyholders.

Now, insurance companies are attempting to chip away at that edifice that has stood without judicial challenge for over 50 years. In Oxford Realty Company Cedar v. Travelers Surplus & Excess Co., __ N.J. __ (2017), the court referenced the concept of the "sophisticated insured" in denying coverage. See also Templo Fuente da Vida Corp. v. National Union Fire Insurance Co., 224 N.J. 189 (2016). Pursuant to this concept, which the new Restatement of Insurance rejected, the insurance companies assert that a company of a certain size that makes use of the services of an insurance broker should not receive the benefit of the adhesion contract principle and the rules of construction that flow from it. As the court noted in *Oxford Realty*, "Insureds procure surplus lines policies covering commercial risk through insurance brokers, thus involving parties on both sides of the bargaining table who are sophisticated regarding insurance matters."

This represents a fundamental misconception of how insurance works. The insurance industry uses standard form policies that the policyholders do not negotiate or draft. The corner candy store and the billion dollar corporation receive the same insurance policy provisions. Neither negotiates its policy's terms. The insurance industry offers them both the same key terms on a take it or leave it basis. As the Appellate Division stated: "Our courts have thus adopted the principle giving effect to the 'objectively reasonable expectations' of the insured for the purpose of rendering a 'fair interpretation' of the boundaries of insurance coverage. [Citations omitted.] These principles are no less applicable merely because the insured itself is a corporate giant." *CPS Chemical Co. v. Continental Insurance Co., 222 N.J. Super. 175 (App. Div. 1988).*

One may ask, what of the insurance broker? Once again, both candy stores and the billion dollar corporation use

insurance brokers. The broker's role is principally to secure the best price for its client. A broker may also advise a client on what types of insurance policies it needs. For example, every broker should caution its clients that they should have employment practices liability insurance. The broker may even review insurance policies from different insurance companies to see if any differences exist; occasionally, one insurance company will revise its policy while another has not.

As a general rule, though, the broker does *not* negotiate policy terms with the insurance company. The broker's world is circumscribed by the conditions, definitions and exclusions prescribed by the insurance industry. This is easily demonstrated by a case law review. Among the hundreds of cases on liability insurance policies, locate one that does not employ the term "occurrence," or one in which the parties negotiated a different term. Of the hundreds of cases since 1986 addressing pollution, locate one in which the policy does not contain an absolute pollution exclusion. On a single day in 1996, the Appellate Division addressed eight cases dealing with the "owned property" exclusion. The policyholders ranged from individuals to Armstrong Industries. The exclusions in the eight cases were identical, and the Appellate Division used the same construction in all of the cases, regardless of the size of the policyholder. The Supreme Court recently addressed the issue of the "no assignment" clause and surveyed case law from around the country, most of which arose from claims by large corporations. *Givaudan Fragrance Corp. v. Home Insurance Company, __ N.J. __ (2017).* Every policy had the identical "no assignment" clause. None of the cases indicated that the parties negotiated the term, or that it was possible to purchase a policy without a no assignment clause.

Is policy language ever jointly drafted by the corporation and the insurance company? Yes. However, this is rare, and the insurance industry has developed a specific term of art—"manuscripted"—to identify insurance policy terms that were jointly drafted. In such cases, as to that negotiated language only, the policy is not an adhesion contract. The Appellate Division has explained: "[O]nly where it is clear that an insurance policy was 'actually negotiated or jointly drafted,' and where the policyholder had bargaining power and sophistication, is the rule of strict construction of policy terms against the insurer not invoked." *Diamond Shamrock Chemicals Co. v. Aetna Cas. & Surety Co., 258 N.J. Super. 167, 209 (App. Div. 1992).*

Oxford Realty concerned a Superstorm Sandy claim under a property policy. The policy had a limit of $1 million and an endorsement stating that there was debris removal coverage of $500,000. The dispute concerned whether the $500,000 was within the policy limit or in addition to it. The court held that the insurance policy was unambiguous, and ruled in favor of the insurance company. This drew a blistering dissent, which relied on the traditional rules of insurance policy construction and found that "Although Oxford is a commercial entity, there is no evidence to suggest that it negotiated the terms of the insurance contract with Travelers."

Oxford Realty, according to its website, is a family-owned real estate business operating in New York, New Jersey and Pennsylvania. The Supreme Court did not adduce any evidence that Oxford Realty was a corporate behemoth or had any bargaining power. The Supreme Court remarked in the context of its sophisticated insured discussion that Oxford Realty used an insurance broker. This is hardly surprising. Almost every company in America uses an insurance broker. That is how the insurance industry sells its product in America.

The court relied principally on three cases in its discussion of sophisticated insured.

The first did not involve an insurance policy but rather a matrimonial agreement. *Pacifico v. Pacifico, 190 N.J. 258, 267 (2007).* The second was a case between two insurance giants. *Chubb Custom Insurance Co. v. Prudential Insurance Company of America, 195 N.J. 231, 238 (2008).* The third case did discuss whether the policyholder was a sophisticated insured. *Werner Industries v. First State Insurance Co., 113 N.J. 30 (1988).* However, the case did not stop there. The court returned the case to the lower court for fact findings on sophistication: *"We therefore remand the matter, as we did in Sparks v. St. Paul Ins. Co. [citation omitted], to permit the trial court to consider proof of whether 'the terms of this policy were specifically understood and bargained for.'" Id.*

No such fact findings took place in *Oxford Realty*. The Supreme Court did not find that the parties had negotiated the policy language in question. A court cannot assume sophistication. It is a fact issue dependent upon whether actual negotiation of a specific policy term took place. *See Gil v. Clara Maass Medical Center,* __ N.J. Super. __ (App. Div. 2017) (court relied on deposition testimony of underwriter as to drafting of policy by the parties). Since the sophisticated insured argument is in the nature of an exclusion, the insurance company should have the burden of proof of demonstrating that the parties actually negotiated a policy term before a court holds that the doctrines of contra proferentem and reasonable expectations do not apply.•

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