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Commentary

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I. Introduction

In the span of less than one month, three New Jersey courts ruled on a narrow legal issue that pervades every area of insurance coverage law — when, if ever, a policyholder's reasonable expectations can trump even unambiguous policy language and create coverage that the insurance contract would not otherwise afford.[1] Each of the three decisions is quite thoughtful and internally consistent. But, when the three opinions are read together, there is a near-perfect circularity of reasoning.

The general rule is that unambiguous policy terms are to be enforced. To the extent that it disregards clear policy language, reasonable expectations doctrine is an exception to that general rule. In the recent decisions, courts sought to discern a legal principle to guide the determination about when to apply the rule and when to apply the exception. As illustrated below, courts came up with irreconcilably inconsistent results.[2]

II. American Wrecking Corp. v. Burlington Ins. Co.

In American Wrecking Corp. v Burlington Ins. Co., 400 N.J. Super. 276 (App.Div. 2008), the Appellate Division was called upon to interpret a "'cross liability' coverage exclusion for, among other things, personal injury to an 'employee of any insured'." The injuries were sustained at a construction site by three employees of additional insureds. None of the accident victims were employed by the named insured. As noted above, the cross liability exclusion was broadly-worded, barring coverage of claims for injury to "any" insured. The trial court correctly deemed the exclusion unambiguous, but declined to enforce it, finding that enforcement would violate the insureds' reasonable expectations. The Appellate Division reversed and ruled in the insured's favor. The result is clearly correct and unremarkable. It is the court's reasoning that makes for interesting fodder.

After announcing its conclusion, the court proceeded to explain its rationale, first reciting what it believed to be the salient facts and summarizing the parties' contentions and then offering its legal analysis. In its factual synopsis, the court pointed out that the named insured engaged in a high risk business (demolition), needed to resort to the surplus lines market to obtain liability coverage and was assisted by a broker in the process. In its legal analysis, the court reiterated:

> The context in which the issue arises is important, and our review must take into account that we are dealing with policies 'covering commercial risks procured through a broker, and thus involving parties on both sides of the bargaining table who were sophisticated with regard to insurance.' . . . Nor can we lose sight of the fact that the insureds were engaged in high risk enterprises

> for which insurance could only be obtained from a surplus lines carrier.

Id. at 283. Though the court did not say it in so many words, the inescapable import of its observation is that broker-aided insureds engaged in high risk enterprises should temper their expectations relating to coverage, particularly that obtained in the surplus lines market. That is a potent arrow that insurers should place in their quivers for future use.

Addressing the applicability of the exclusion, the court deemed "crystal clear" the broadening effect of the phrase "any insured," as distinct from "the insured" (emphasis added). The additional insureds argued that the exclusion was rendered ambiguous by a severability clause providing that "except with respect to the Limits of Insurance . . . this insurance applies . . . as if each Named Insured were the only Named Insured." The court found that the severability clause did not create an ambiguity, noting that the clause could not "negate" a "plainly worded" exclusion.

The court then considered whether reasonable expectations doctrine warranted a different result. The court cited two lines of Supreme Court decisions and described them as "not easily reconcilable." One string of cases holds that reasonable expectations can sometimes overcome even unambiguous policy language. The other line of decisions holds that reasonable expectations are not relevant unless the policy is too confusing for an average policyholder to understand.

Relying on Nunn v. Franklin Mutual Ins. Co., 274 N.J.Super. 543, 549 (App.Div. 1994), the American Wrecking court found that the more policyholder-indulgent rule should only apply to homeowners policies and the insurer-friendly rule should govern in the commercial context. Because the case before it involved a commercial policy, the court held that reasonable expectations doctrine could not defeat the clear policy terms.

American Wrecking made a couple of other points worth noting. Reasonable expectations doctrine is usually invoked by policyholders at the first sign of resistance. If that fails, resort to "public policy" often comes next. In American Wrecking, the court extinguished that argument as well, stating, "public policy considerations alone are not sufficient to permit a finding of coverage in an insurance contract when its plain language cannot fairly be read to otherwise provide that coverage." (quoting State, Department of Environmental Protection v. Signo Trading International, Inc., 130 N.J. 51, 66 (1992)).

The additional insureds, however, were nothing if not persistent. They also asserted the actual negotiations had taken place regarding the scope of the "cross liability" endorsement and claimed that the terms of the endorsement ultimately incorporated in the policy were different than those to which the parties agreed. Specifically, the insureds argued that the exclusion "was 'snuck' into the policy." The contention would appear to at least raise a factual question about the appropriateness of reformation of the policy to comport with the parties' mutually expressed intentions. The court rejected the argument on the following grounds:

> Since [the broker] continued to negotiate after receiving the policy with the 'cross liability' endorsement, and since the accidents happened quite some time later, there was no prejudice and the policy terms govern.

Id. at 280 n.1. Based on the passage of time and the broker's post-issuance scrutiny of policy terms, the court, thus, appeared to infer the insured's acquiescence to the actual policy terms, even though they may have varied from the negotiated terms. In dispensing with the reformation argument, American Wrecking cited only one decision, Edwards v. Prudential Property and Casualty Co., 357 N.J.Super. 196 (App.Div.) certif. denied 176 N.J. 278 (2003). In Edwards, the court rejected an argument that insurers have some duty to educate or counsel policyholders about the contents of their policies. Id. at 204 ("Our courts have held fast to the general rule that an insured is chargeable with knowledge of the contents of an insurance policy in the absence of fraud or inequitable conduct on the part of the carrier.")

III. North Plainfield Board Of Education v. Zurich American Ins. Co.

In North Plainfield Board of Education v. Zurich American Insurance Company, 2008 U.S. Dist. LEXIS 39555 (D.N.J. May 15, 2008), the court also addressed the parameters of reasonable expectations

doctrine, but defined those parameters differently than American Wrecking. North Plainfield was spawned by a $30M school construction project which deteriorated into litigation and resulted in multiple claims under various types of policies. The substantive issues were complex and are not relevant to this discussion. Instead, the focus is on the court's comments regarding reasonable expectations doctrine.

The court began by citing the familiar rule that clear policy language should be enforced as written and ambiguous language should be construed in a manner that benefits the insured. The court noted that a policy may be deemed ambiguous "even if a close reading of the written text" does not support the insured's position. (citing Fezschak v. Pawtucket Mutual Ins. Co., 2008 U.S.Dist.LEXIS 29295 (D.N.J. Apr. 8, 2008).

Like American Wrecking, North Plainfield acknowledged the line of cases that contradict the rule it previously cited, stating that the New Jersey Supreme Court "has recognized that in exceptional circumstances, insurance policies should be construed to reflect the reasonable expectations of the insured even when the literal meaning of the policy is plain and clear." The court added, however, that the "Third Circuit has concluded that 'exceptional circumstances' warranting a court to construe a clear and unambiguous policy exclusion in accordance with the reasonable expectations of the insured rather than in accordance with the exclusion's plain language, arise only when literal application of the exclusion would violate public policy." (citing Colliers Lanard & Axilbund v. Lloyds of London, 458 F.3d 231, 237 (3rd Cir. 2006)).

IV. Villa v. Short

In recent commentary regarding reasonable expectations doctrine, the New Jersey Supreme Court was faithful to the post-Kievit limitations. In Villa v. Short, 2008 N.J. LEXIS 604 (June 5, 2008), the Supreme Court addressed virtually the same issue that the Appellate Division ruled upon in American Wrecking, the distinction between an exclusion's triggering being linked to certain action by "any" insured, as opposed to "the" insured. There was, however, one key dissimilarity. In American Wrecking, the court had interpreted a commercial policy. In Villa, the court construed a homeowner's policy. In its discussion of the "controlling principles" guiding policy interpretation, the Villa court stated:

> . . . we look to the plain language of the policy. 'If the terms are clear, courts should interpret the policy as written and avoid writing a better insurance policy than the one purchased.' President v. Jenkins, 180 N.J. 550, 562 (2004) (citing Gibson[v. Callaghan, 158 N.J. 662, 670 (1999)]. However, if the policy language is ambiguous, we construe the language to 'comport with the reasonable expectations of the insured.' Zacarias v. Allstate Ins. Co., 168 N.J. 590, 595 (2001).

V. The Inconsistency And The Resolution

With respect to clashes between plain language and public policy, American Wrecking and North Plainfield reach precisely the opposite result. North Plainfield held that only public policy can override plain language. American Wrecking held that, if the language is plain, public policy is irrelevant.

As noted above, Villa reached the same substantive result as American Wrecking and, at first blush, the decisions appear to be consistent. But here is the catch. Villa involved a personal policy. Recall that, in American Wrecking, the court suggested that, in cases involving personal policies, reasonable expectations were not necessarily constrained by unambiguous policy language. Villa held otherwise, declaring that, even when personal policies are involved, reasonable expectations are not relevant unless the policy is adjudged to be ambiguous.

The American Wrecking and North Plainfield courts are not to be faulted for their intelligent decisions. The courts were charged with what appears to have been an impossible task, identifying a legal principle to guide the decision on whether to apply the rule (unambiguous policy language is controlling) or its exception (reasonable expectations can overcome even unambiguous policy language). Judging by the disparity in results of the respective efforts to identify such a principle, it is probably safe to say that none exists. In Villa, however, the New Jersey Supreme Court was free to take a more active role and did offer guidance for harmonizing the seemingly-conflicting canons of insurance contract interpretation.

The most recent pronouncements from the ultimate arbiter appear to evidence a trend toward constriction of reasonable expectations doctrine to the point where it adds nothing to the more well-defined contra preferentem rule. Villa is illustrative but Shotmeyer v. New Jersey Realty Title Ins. Co., 2008 N.J.LEXIS 603 (June 5, 2008) makes the point even more forcefully:

> In the absence of an ambiguity, an insurance policy should be interpreted according to its plain, ordinary meaning. When an ambiguity exists, courts should interpret the contract in accordance with the "reasonable expectations" of the insured. However, courts must guard against rewriting policies in favor of the insured under the guise of interpreting a contract's reasonable terms.
>
> The purposes behind these principles are evident. Policyholders should be protected from "technical encumbrances" and "hidden pitfalls" in their insurance contracts. Sophisticated insurers who unilaterally prepare complicated contracts should not be allowed to take advantage of their less sophisticated customers. However, because insurance premiums are based on predictable levels of risk . . . insurers need to rely on certain consistent conditions in order to calculate premium rates reliably.

Conditioning the applicability of reasonable expectations doctrine on the existence of a policy ambiguity effectively renders it a useless appendage.[3] If the policy is adjudged to be ambiguous, the insured will prevail based on the contra preferentem rule. Reasonable expectations doctrine will add nothing to the analysis.[4] Since Kievit, the New Jersey Supreme Court appears to have come full circle. Once touted for breathing independent vitality into reasonable expectations doctrine, the New Jersey Supreme Court now seems content to allow it to atrophy.

The Supreme Court's recent rulings implicitly recognize that, if a court chooses to ignore clear insurance contract language, that decision must be based on something more than a nebulous, self-serving expectation. In stark contrast to a reasonable expectations assertion, a public policy based challenge to a coverage restriction cannot be based on some personal tale of woe. See, e.g., Zuckerman v. National Union Fire Ins. Co., 100 N.J. 304, 320 (1985) ("The term 'public policy' contemplates a standard measured by the impact on the public at large rather than the individual."); Allen v. Commercial Casualty Ins. Co., 131 N.J.L. 475, 478 (E. & A. 1944); Rotwein v. General Accident Group, 103 N.J. Super. 406, 417 (Law Div. 1968) ("It must be emphasized that public policy will usually not be applied to invalidate a contract unless there is some definite basis therefore in law, legal precedent or recognized governmental policy affecting the general welfare.")

If there is clarity of expression in the coverage-limiting terms of an insurance contract that the law requires a policyholder to read and if there are no public policy based reasons why the language should not be enforced, then any expectation of coverage would necessarily be unreasonable and the insurance policy should be enforced per its plain terms. Fortunately for insurers, the New Jersey Supreme Court appears to see things the same way. To those searching for an answer to the question regarding when reasonable expectations, standing alone, can overcome clear policy language, the New Jersey Supreme Court has offered a most emphatic and direct answer — never.

Endnotes

1. The New Jersey Supreme Court first espoused the reasonable expectations doctrine in Kievit v. Loyal Protection Life Ins. Co., 34 N.J. 475 (1963). Commentators hailed Kievit as a "seminal" decision because it appeared to give reasonable expectations doctrine some life independent of the contra preferentem rule. J. Stempel, Law of Insurance Contract Disputes, Section 4.09(b), n. 330 (Aspen 1995)(citing W.Mayhew, Reasonable Expectations: Seeking a Principled Application, 13 Pepperdine L. Rev. 267, 273 (1986)). Kievit is a classic example of difficult facts making bad law. There, coverage was denied to the holder of an accidental disability policy whose demise was indisputably brought about by an accident. The insurer denied coverage based on what amounted to an anti-concurrent cause exclusion. The

court observed that, almost any serious affliction affecting an elderly person can be viewed as stemming from multiple causes, and that, if the policy were enforced per its literal terms, the coverage would be illusory. The court, therefore, declined to enforce the policy, as written, and, to be clear, made no finding of ambiguity. In Linden Motor Freight Co., Inc. v. Travelers Ins. Co., 40 N.J. 511, 525 (1963), the court went out of its way to rein in Kievit, stating that the decision "was not intended" to displace the rule that "clear basic terms and particular provisions of an insurance contract may not be disregarded at will and a new contract judicially made for the parties." Id. at 525-526.

2. Other courts have also struggled to define the limits of reasonable expectations doctrine. A. Windt, Insurance Claims and Disputes, §6:3 (Thomson West 5th ed. 2007) ("The reasonable expectations rule . . . abandons the general contract principle that the insured's legitimate expectations are necessarily governed and limited by terms of the policy. That principle will, instead, be applied only when it is fair to do so. As a result, in a proper case, an insured may be held to be entitled to coverage despite unambiguous language in the policy to the contrary. Unfortunately, however, the courts have had little success in formulating a test for determining when equity necessitates that the reasonable expectations rule be applied.").

3. Reasonable expectations doctrine is pure legal fiction. After experiencing a loss that the policy unambiguously places beyond coverage, almost every policyholder will privately rue the decision not to purchase more expansive coverage yet can publicly avow that the coverage-limiting terms violate his or her reasonable expectations. The truth is that, in almost every case, the insured had no antecedent thought of any kind regarding whether the claim was within the scope of coverage. In the rare case where a policyholder did foresee a claim that is outside the scope of plain policy terms, the reasonable expectations argument is even less sympathetic. Had the more prescient insured satisfied its obligation to read this policy, it would have discovered the gap in coverage and could have purchased broader coverage commensurate with its insurance needs.

4. In declaratory actions, insurers generally favor a dispassionate analysis focusing on contract terms and clinical, minimalist description of the facts underlying the loss. Jury research suggests that it is in the interest of policyholders to humanize the controversy and appeal to the emotions of the factfinder. Another very recent decision, Lancos v. Silverman, 946 A.2d 1073 (App.Div. 2008) scores one for the insurers. The case arose from the collapse of an upper level deck at a shore rental home. Sixteen people injured in the collapse sued the homeowners. The owners' liability coverage had lapsed, however, and they brought a malpractice claim by an insured against their broker. In the professional liability action, the owners' sought to inform the jury of the horrific facts of the deck collapse, ostensibly for the purpose of allowing the jury to grasp the "magnitude of liability" to which the property owners were "exposed." The trial court barred the owners from so informing the jury, finding that that the information would be "highly prejudicial" to the broker. The Appellate Division affirmed the trial court's ruling. There is a distinction between Lancos and most coverage actions. In Lancos, the issue was the broker's culpability for the conceded non-existence of coverage. In most coverage actions, there is no dispute regarding the existence of a policy. The factfinder, however, is charged with determining whether the claim fits within the parameters of coverage. To perform that task, some information regarding the facts of the underlying claim is necessary. Typically, though, the factfinder will have no need to know the magnitude of the liability. Under the Lancos rationale, the information should be excluded for its prejudicial effect. ■

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