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**WALLOWING IN AMBIGUOUS COVERAGES - SHOULD
AMBIGUITIES IN A SURETY BOND OR A FIDELITY POLICY
NECESSARILY BE CONSTRUED AGAINST THE SURETY OR
FIDELITY CARRIER?**

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Introduction

The doctrine of contra proferentem ("the Contra Doctrine") is a rule of contract interpretation, which counsels that ambiguities in a contract are to be construed against the drafter.¹ The courts have stated different rationales for the rule though many of these rationales substantially overlap. These include the following:

- Ambiguities should be resolved against the drafter since the drafter will be guided by his/her own interests and will likely choose shadings of expression to conform to his/her own interests, including word choices whose significance may not be fully comprehended or intended by the other contracting party.²
- Ambiguities should be resolved against the drafter since the drafter is best situated to avoid uncertain meanings and therefore should bear the burden of his/her failure to do so.³

The Contra Doctrine poses an impediment to litigating coverage issues under fidelity policies and surety bonds since policy or bond terms are often drafted or selected by the fidelity carrier or the surety. However, in some jurisdictions, the application of the Contra Doctrine in insurance coverage cases is referred to as the "contra-insurer rule,"⁴ reflecting decisions on the part of some courts to apply the doctrine especially strictly against insurers in a manner that may have little relevance to the doctrine's underlying rationale. Courts that apply a heightened Contra Doctrine against insurers tend to shift the rationale of the rule to adhesion principles; i.e., the alleged unfair bargaining leverage that an insurer wields over the insured.⁵ This additional overlay to the Contra Doctrine, where applicable, may result in courts construing policy or bond terms in ways that are at war with the history of the policy or bond, create inconsistencies with other terms of the same document, or yield a result which is inconsistent with the practices and expectations of either the insurance industry or the insured's line of business.⁶

There is no reasonable possibility that the Contra Doctrine will be abandoned by the courts.⁷ However, it is possible to identify litigation strategies that can, in some contexts, limit its impact as applied to insurers and sureties to traditional contract construction considerations and away from "adhesion" factors. This paper will suggest approaches that may be useful to

¹ See Dingus and Haley, The Doctrine of Contra Proferentem in Fidelity Coverage Cases, 10 Forum 75 (1974) ("Forum").

² Hansen v. Ohio Casualty Insurance Co., 239 Conn. 537, 544 (1996) ("Hansen"). See Restatement of Contracts Second § 206 at p. 105; 17A Am. Jur.2d Contracts § 348 at pp. 360-63; 43 Am. Jur.2d Insurance §§ 283 & 284 at pp. 357-60.

³ Id. See AIU Insurance Co. v. Superior Court, 51 Cal.3d 807, 821-23 (1990)

⁴ Hansen, supra, 239 Conn. at 544.

⁵ See Cincinnati Insurance Co. v. Hopkins Sporting Goods, 522 N.W.2d 837 (Iowa 1994); Bankers Life Co. v. Aetna Casualty and Surety Co., 366 N.W.2d 166 (Iowa 1985). See also Paul Revere Life Insurance Co. v. Haas, 137 N.J. 190, 199 645 A.2d 136 (1994).

⁶ Corbin specifically endorses the application of the Contra Doctrine to redress disparities in bargaining power among contracting parties, particularly between insurers and the insureds. See 24 Corbin on Contracts, §24.27 at pp. 292-95.

⁷ There are a few jurisdictions which do not subscribe to the Contra Rule. See Kendal v. Nationwide, 348 Md 157, 702 A.2d 767 (1997); Nichols v. State Farm Fire & Casualty Co., 175 Ariz. 354, 857 P.2d 406 (1993); Malloy v. Head, 90 N.H. 58, 4 A.2d 875 (1939).

a surety or fidelity carrier in minimizing some of the more onerous implications of the Contra Doctrine in fidelity or surety coverage disputes.

Limiting the Scope of the Doctrine to its Traditional Underlying Purpose

If the traditional purpose of the Contra Doctrine is to counter-balance the advantages that may accrue to the drafter of a contract, the doctrine should only be applicable to the extent that one party drafted the policy or bond or determined its terms to the exclusion of input from the other party.

This self-limiting principle is illustrated in many decisions where the courts are asked to construe policy provisions, which are dictated by statute or government entities.⁸ In such cases, the true question should be the intent of the legislature or the sponsoring public agency and not the intent of the parties to the contract or whether either party benefited itself through the drafting process.⁹ Many courts have reached this conclusion and have refused to apply the Contra Doctrine to construe policy terms, which are dictated by statute or administrative edict.¹⁰ In contrast, there are cases where courts have applied the Contra Doctrine against an insurer even where the allegedly ambiguous policy provision is imposed by statute.¹¹ These decisions pose significant policy concerns since automatically construing government-dictated language against the carrier to find coverage for an insured can result in negating the legislative or governmental intent underlying the required terms or leading to inconsistent applications of laws or administrative decision-making.¹²

The courts have also refused to apply the Contra Doctrine in contexts where an insured actually negotiates and/or jointly drafts an insurance policy.¹³ Some of these cases can be read for the proposition that the Contra Doctrine should be less applicable where the insured is a large, sophisticated company.¹⁴ However, the key issue should not be the size and sophistication of the insured, but rather whether the insured drafted and negotiated in regard to policy terms. That the insured is large and sophisticated is properly relevant solely as

⁸ See Terra Industries v. Com. Ins. of America, 981 F.Supp. 581, 589-91(N.D.Ia. 1997); Matarese v. New Hampshire Municipal Assn., Etc., 147 N.H. 396, 401-2, 791 A.2d 175, 179 (2002); Pappas Enterprises v. Commerce & Industry Insurance Co., 422 Mass. 80, 83 661N.E.2d 81, 83 (1996); Paul Revere Insurance Co. v. Haas, 137 N.J. 190, 199, 645 A.2d 136 (1994); State Farm Mutual Auto Insurance Co. v. Messinger, 232 Cal.App.3d 508, 519 283 Cal.R 493 (1991); Midwest T.P. Works, Inc. v. Firemen's Insurance Co., 36 Ill.App.2d 65, 69, 183 N.E.2d 562 (1962).

⁹ Id.

¹⁰ Id. See Restatement of Contracts Second § 206 at p. 105 ("The rule that language is interpreted against the party who chose it has no direct application to cases where the language is prescribed by law, as is sometimes true with respect to insurance policies, bills of lading and other standardized documents.")

¹¹ 24 Corbin on Contracts, §24.27 at p. 295. See Hoekstra v. Farm Bureau Mutual Insurance Co., 382 N.W.2d 100 (Iowa 1986); Ott v. American Fidelity and Casualty Co., 161 S.C. 314, 159 S.E. 635 (1931); Cottingham v. Insurance Co., 168 N.C. 259, 265 (1915); Matthews v. American Central Insurance Co., 154 N.Y. 449, 456-7, 48 N.E. 751 (1897).

¹² Id.

¹³ See Pittson Company v. Allianz Insurance Company, 124 F.3d 508, 520-21 (3rd Cir. 1997); New Castle County v. Hartford Accident & Indemnity Co., 933 F.2d 1162, 1189 (3rd Cir. 1991); Owens-Illinois, Inc. v. United Insurance Co., 625 A.2d 1, 15 (N.J. Super.App. Div. 1993), rev'd on other grounds, 650 A.2d 974 (N.J. 1994).

¹⁴ Id.

evidence of the fact that it knowingly participated in the drafting of the allegedly ambiguous policy or bond.¹⁵

In sum, one tactic for limiting the adverse consequences of the Contra Doctrine is to argue the doctrine's inapplicability in contexts where either the insured participated in negotiating and drafting the allegedly ambiguous policy or bond or where neither the insured nor the insurer drafted the policy or bond at issue.

Arguing that a Term is not Ambiguous

Courts have differing thresholds for determining when a policy or bond term is "ambiguous," thereby invoking the Contra Doctrine. In some cases, courts apply the Contra Doctrine simply because a policy or bond term is unclear on face and would require an analysis going beyond a facial reading in order to determine its true meaning. Where courts use the Contra Doctrine in lieu of conducting a reasoned analysis, they generally set out very minimal prerequisites for invoking the doctrine. For example, consider the following formulations of the doctrine which are commonly reflected in the case law:

[I]f there are two reasonable interpretations to be given to the language of an insurance contract, a court must apply the interpretation that sustains coverage.¹⁶

When the meaning of terms in an insurance policy is susceptible to two interpretations, the one favoring the insured is adopted.¹⁷

[W]here the terms of an insurance policy are susceptible of two interpretations, that interpretation that sustains the claim for indemnity or which allows the great[est] indemnity will be adopted.¹⁸

The construction of an exclusionary clause urged by the insured must be adopted as long as the construction is not itself unreasonable and even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the intent of the parties.¹⁹

This language is suggestive of an intent to level the playing field between insured and insurer rather than attempting to ascertain the most sensible interpretation of the policy or bond terms. Presumably under these formulations, an insured's interpretation of a policy or bond provision may prevail over a carrier's construction that makes more sense and is more consistent with the other terms of coverage and the practices in the insurance industry and the insured's line of business. The unfortunate result may be that any term that is not explicit on

¹⁵ Id. See Eastern Associated Coal v. Aetna Casualty & Surety Co., 632 F.2d 1068, 1075 (3rd Cir. 1980); AIU Insurance Co. v. Superior Court, 51 Cal.3d 807, 822-23, 799 P.2d 1253 (1990); Coca Cola Bottling Co. v. Columbia Casualty Co., 11 Cal.App. 4th 1176, 1185-87 14 Cal. Rptr.2d 643 (1992).

¹⁶ American Casualty Co. v. Continsio, 819 F.Supp. 385 (D.N.J.1993).

¹⁷ See Amco Insurance Co. v. Rossman, 518 N.W.2d 333, 334 (Iowa 1994); North Star Mut. Ins. v. Holly, 402 N.W.2d 452, 454 (Iowa 1987).

¹⁸ Dorfman v. Aetna Life Insurance Co., 342 So.2d 91, 93 (Fla.App. 1977).

¹⁹ Adrian Associates General Contractors v. National Surety Corp., 638 S.W.2d 138, 140 (Tex.App. 1982).

face is construed against the insurer or surety, very possibly significantly distorting the meaning of the bond or policy in the process.

Properly applied, the Contra Doctrine is not intended as a substitute for careful analysis and a fair evaluation of the scope of coverage. Courts which apply the doctrine as a tool of contract construction rather than as an "adhesion" principle set out a much higher threshold for identifying "an ambiguity" that must be construed in the insured's favor. Consider the following language:

We agree with the district court that the phrase...[is ambiguous]...when considered in isolation....

We are not charged, however, with considering the phrase in isolation. Rather, "the language of an insurance policy must be construed with reference to the risk, subject matter and purpose of the policy." Show Car Speed Shop, Inc. v. United States Fidelity & Guarantee Co., 192 A.D.2d 1063, 1064, 596 N.Y.S.2d 608, 609 (4th Dept. 1993)...We will find a word or phrase ambiguous and, hence, subject to rules of construction against the drafter only

When it is capable of more than a single meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business.

United States Fire Insurance Co. v. General Reinsurance Corp., 949 F.2d 569, 572 (2d Cir. 1991)....²⁰

This kind of formulation provides far greater assurances that a court will carefully analyze the policy or bond terms and adopt the insured's construction only where there are two equally proper constructions to select from.

In addition, the Contra Doctrine should only be operative where a policy or bond term remains "ambiguous" after applying all of the other standard principles of contract

²⁰ Sea Insurance Co. v. Westchester Fire Insurance Co., 51 F.3d 22, 26 (2d Cir. 1995). See Sharp v. Federal Savings and Loan Insurance Corp., 858 F.2d 1042, 1046 (5th Cir. 1988) ("The special rules of interpretation do indeed apply only when there is an ambiguity; courts ought not to strain to find such ambiguities, if, in doing so, they defeat probable intentions of the parties. This is so even when the result is an apparently harsh consequence to the insured."), quoting Calcasieu-Marine National Bank v. American Employers' Insurance Co., 533 F.2d 290, 296 (5th Cir.), cert. denied, 429 U.S. 922 (1976).

interpretation.²¹ The rule is a kind of "tie-breaker," to be applied only where substantial uncertainty remains following a full and complete analysis and consideration of all of the principles of contract interpretation.²² Therefore, a court should not invoke the Contra Doctrine until it has:

- taken into account established customs and business practices;
- given effect to every clause of the policy or bond to create a consistent whole;
- discarded absurdities of interpretation; and
- given a reasonable, fair and practical construction and meaning to every term.²³

The Contra Doctrine is far less harsh where the preference accorded the insured is invoked only after the court has carefully evaluated the text of the term at issue, its interplay with other policy and bond terms, the history of the policy or bond form, the standards and practices in the insurance or surety industry, and the standards and practices in the insured's industry and has concluded that there are two entirely sensible constructions of the policy or bond term at issue.

In sum, the harsh effects of the Contra Doctrine can be substantially minimized where the doctrine is applied as a rule of construction rather than as an adhesion principle and where the rule is invoked only where a court has concluded after a fair, complete and thorough analysis that there are two entirely sensible interpretations of the policy term in dispute.

Applications of the Contra Doctrine in Fidelity Cases

²¹ See Todd v. AIG Life Insurance Co., 47 F.3d 1448, 1451 (5th Cir. 1995); Yardley Drilling Co., Inc. v. Erickson Paving Co., 465 F.2d 396,400 (9th Cir. 1972); Saturn Oil And Gas Co. V. N. Natural Gas Co., 359 F.2d 297, 302 (8th Cir. 1966); Boswell v. Chapel, 298 F.2d 502, 506 (10th Cir. 1961); Gulf Refining Co. v. Home Indemnity Co., 78 F.2d 842, 843-44 (8th Cir. 1935); Nationalcare Corp. v. St. Paul Property & Casualty, 22 F.Supp.2d 558, 564, n. 11 (S.D.Miss. 1998); Empacadora Puertorriquena De Cames, Ltd. v. Alterman Transport Line, Inc., 303 F.Supp. 474, 479 (D.P.R. 1969); Indiana-Kentucky Electric Corp. v. Green, 476 N.E.2d 141, 146 (Ind.App. 1985); United California Bank v. Prudential Insurance Co., 140 Ariz. 238, 302, 681 P.2d 390 (1983); Beck v. Hoel-Steffen Construction Co., 605 S.W.2d 810, 813 (Mo.App. 1980). Accord 17A Am.Jur.2d Contracts §348 at p. 360-63; Forum, supra, at p. 87.

²² See Residential Marketing Group v. Granite Investment Group, 933 F.2d 546, 549 (7th Cir. 1991); Indiana-Kentucky Electric Corp. v. Green, supra, 476 N.E.2d at 146.

²³ Forum, supra, at 87.

The Contra Doctrine is commonly invoked in coverage litigation regarding the scope of the terms of fidelity policies.²⁴

The applicability of the Contra Doctrine to construing provisions of the Banker's Blanket Bond is particularly problematic. Proposed changes to the form are typically drafted by the Surety Association of America and then submitted to the American Banker's Association for its review and comment.²⁵ The two associations have liaison committees which meet to discuss the bond's language and proposed coverage changes. While the surety industry is not obligated to accept the views of the bankers, the bankers' suggestions are often accounted for in the final document and there is a documented history of a collaborative process between the two industries in connection with the text of the bond.²⁶

Based on this history, fidelity carriers have argued that the Contra Doctrine is inapplicable in coverage disputes regarding the terms of the Banker's Blanket Bond since the language is the produce of a collaborative effort between fidelity carriers and the insureds. Some courts have rejected this argument based on the conclusions that the plaintiff insured had not participated directly in any such negotiations with the defendant carrier regarding the policy at issue, the plaintiff insured was not a member of the American Bankers Association, and/or that the American Bankers Association did not exercise sufficient leverage over the final language of the bond to warrant a conclusion that it had meaningfully participated in the drafting process.²⁷ In contrast, the better reasoned cases have determined that the banking industry has and continues to exercise a significant impact on the drafting of the Blanket Banker's Bond and that, therefore, the Contra Doctrine does not apply in coverage litigation regarding the terms of the bond form.²⁸

²⁴ See, e.g., Pittson Company v. Allianz Insurance Co., 124 F.3d 508, 520-21 (3d Cir. 1997); Transamerica Premier Insurance Co. v. Miller, 41 F.3d 438-441 (9th Cir. 1994); Oritani Savings and Loan v. Fidelity & Deposit Co., 989 F.2d 635, 638 (3rd Cir. 1993); United States Fire Insurance Co. v. F.D.I.C., 981 F.2d 850, 851 (5th Cir. 1993); Sharp v. F.S.L.I.C., 858 F.2d 1042, 1046 (5th Cir. 1988); First National Bank v. INA, 424 F.2d 312, 317 (7th Cir. 1970), cert. denied, 398 U.S. 939 (1970); First National Bank v. United States Fidelity & Guarantee Co., 416 F.2d 52, 56 (5th Cir. 1969); American Casualty Co. v. Continisio, 819 F. Supp. 385 (D.N.J. 1993); Federal Savings and Loan Insurance Co. v. Transamerica Insurance Co., 661 F. Supp. 246, 250 (C.D.Cal. 1987); Shearson/American Express v. First Continental Bank, 579 F. Supp. 1305, 1309-11 (W.D. Mo. 1984); Shoals National Bank v. Home Indemnity Co., 384 F.Supp. 49 (N.D.Ala. 1974); Bankers Life Co. v. Aetna Casualty and Surety Co., 366 N.W.2d 166 (Iowa 1985); State Bank v. Capitol Indemnity, 61 Wis. 2d 699, 214 N.W.2d 42, 43, n.1 (1974).

²⁵ Forum, supra at 80-82.

²⁶ Id.

²⁷ See First National Bank v. INA, 424 F.2d 312, 317 (7th Cir. 1970), cert. denied, 398 U.S. 939 (1970); First National Bank v. United States Fidelity & Guarantee Co., 416 F.2d 52, 56 (5th Cir. 1969); Federal Savings and Loan Insurance Co. v. Transamerica Insurance Co., 661 F. Supp. 246, 250 (C.D.Cal. 1987); Shoals National Bank v. Home Indemnity Co., 384 F.Supp. 49 (N.D.Ala. 1974).

²⁸ See Oritani Savings and Loan v. Fidelity & Deposit Co., 989 F.2d 635, 642 (3rd Cir. 1993); United States Fire Insurance Co. v. F.D.I.C., 981 F.2d 850, 851 (5th Cir. 1993); Sharp v. F.S.L.I.C., 858 F.2d 1042, 1046 (5th Cir. 1988); Shearson/American Express v. First Continental Bank, 579 F. Supp. 1305 (W.D. Mo. 1984); State Bank v. Capitol Indemnity, 61 Wis. 2d 699, 214 N.W.2d 42, 43, n.1 (1974).

Applications of the Contra Doctrine in Surety Cases

There are many reported instances where the Contra Doctrine has been invoked in litigation involving the scope of coverage afforded under a surety bond.²⁹

There is precedent for the proposition that the Contra Doctrine is not applicable in circumstances where the obligee or some other party besides the surety chose or drafted the bond form.³⁰ In many circumstances, the obligee presents the surety with either a manuscripted bond form or a form that it has selected from the universe of standard bond forms. In regard to statutory bonds, the required text of the bond may be set out in the statutes or the public obligee may draft a required form as a means of implementing the statute. Under any of these circumstances, the Contra Doctrine should not be apposite.³¹

On the other hand, the impact of the Contra Doctrine in surety cases may be exacerbated by loose language in many decisions to the effect that a compensated surety is not a favorite of the law and therefore its bonds should be construed in a manner most favorable to the claimant.³² When confronted with such language, it is critical that the surety put the interpretative analysis in the proper context; that is, that a preference should not be afforded to the claimant until the court has applied all other contract construction rules, has carefully evaluated the text of the bond, its interplay with other bond terms, the history of the bond form, and the standards practices in the surety and construction industry and has concluded that there are two entirely sensible constructions of the clause at issue.

Conclusion

A surety or fidelity carrier must carefully consider the implications of the Contra Doctrine before opting for litigation regarding the scope of coverage of a bond or fidelity policy. The viability of the doctrine in most jurisdictions is beyond dispute and there is a reasonable likelihood in any coverage dispute that the doctrine will be invoked. If the insured or bond claimant participated in the selection or drafting of the operative bond or policy, a court should find that the Doctrine is inapposite. If the surety or fidelity carrier solely drafted or selected the bond or policy, it must persuade the court to fully analyze the interpretive issues rather than using the Contra Doctrine as a substitute for reasoned analysis.

²⁹ See Fayetteville Investors v. Commercial Builders, Inc., 936 F.2d 1462 (4th Cir. 1991); United States Fidelity and Guaranty Co. v. Braspetro Oil Services, 219 F.Supp.2d 403, (S.D.N.Y. 2002); L&L Builders Co. v. Mayer Associated Services, 46 F.Supp.2d 875 (N.D.Iowa 1999); Marshall Contractors v. Peerless Insurance Co., 827 F.Supp. 91 (D.R.I. 1993); Eagle Fire v. First Indemnity, 280 N.J. Super. 430, 438 (1995); American Bonding Co. v. Nelson, 763 P.2d 814 (Utah App. 1988); Town Of Scotland Neck v. Surety Co., 301 N.C. 331, 271 S.E.2d 501 (1980); Joint Administrative Board v. Fallon, 89 Wn.2d 90, 569 P.2d 1144 (1977); Board of Local Improvements v. St. Paul Fire Insurance Co., 39 Ill.App.3d 255, 257-58, 350 N.E.2d 36 (1976).

³⁰ See Gulf Refining Co. v. Home Indemnity Co., 78 F.2d 842, 843-44 (8th Cir. 1935); National Bank v. Equity Investors, 86 Wash.2d 545, 555, 546 P.2d 440 (1976).

³¹ But see Tomilson v. Sentry Engineering and Construction, 777 F.2d 918 (4th Cir. 1985) (concurring opinion suggests without deciding that the Contra Doctrine may be applicable against a surety writing on a standard FHA bond form).

³² See, e.g., Cam-Ful Industries v. Fidelity & Deposit Co., 922 F.2d 156, 163 (2d Cir. 1991); Eagle Fire v. First Indemnity, 280 N.J. Super. 430, 438 (1995); State Ex Rel. Mt States Mut. Cas. V. Knc, 106 N.M. 140, 740 P.2d 690 (1987).

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