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REPORT

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THE NINTH CIRCUIT COURT OF APPEALS THREATENS TO ERODE CALIFORNIA'S UNIVERSAL TRUTH – THAT AMBIGUITIES IN POLICY LANGUAGE ARE RESOLVED IN FAVOR OF COVERAGE



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When the Ninth Circuit decided *Universal Cable Productions, LLC v. Atlantic Specialty Insurance Company* (9th Cir. 2019) 929 F.3d 1143 (*Universal*), at center stage was its interpretation of the war exclusion in plaintiffs' insurance policy, to which the court assigned a technical meaning rather than its plain and ordinary meaning. (*Id.* at p. 1156 [holding that "'war' has a special meaning in the insurance industry requiring hostilities between de jure and de facto governments"].) To date, legal commentators and courts have avoided shining any spotlight on either the rules of interpretation that the Ninth Circuit utilized in interpreting the policy's war exclusion, and on the sweeping ramifications that the court's analysis could have on well-established California policy-interpretation jurisprudence in the future.

For over five decades, the contra proferentem rule governing a court's interpretation of ambiguous policy language under California law has been settled: "Any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer." (*Crane v. State Farm Fire & Cas. Co.* (1971) 5 Cal.3d 112, 115.) That is because policy language is generally drafted by insurers, who receive hefty premiums from insureds in exchange for coverage. (*Minkler v. Safeco Ins. Co. of America* (2010) 49 Cal.4th 315, 321.)

In line with that well-established rule, the California Supreme Court in *AIU Insurance Co. v. Superior Court* (1990) 51 Cal.3d 807, 822 (*AIU*) required ambiguous policy language to be interpreted in favor of coverage, *unless* an insurer can overcome that presumption by proving:

1. The policyholder is sophisticated and has bargaining power;
2. The policyholder negotiated the specific provision at issue; and
3. The policyholder drafted or jointly drafted the specific provision at issue.

(*Id.* at p. 823 ["It follows, however, that where the policyholder does *not* suffer from lack of legal sophistication or a relative lack of bargaining power, and where it is clear that an insurance policy was actually negotiated and jointly drafted, we need not go so far in protecting the insured from ambiguous or highly technical drafting."].)

Under *AIU*, for insurers to overcome the presumption in favor of coverage they must prove all three of these elements; proving sophistication and negotiation, alone, is insufficient. (51 Cal.3d at p. 823.) California appellate courts agree: “[W]e depart from the normal rule of interpretation, that ambiguities are interpreted in favor of coverage, only where there is ‘evidence that the provision in question was **jointly drafted**; merely showing that policy terms were negotiated, and that the insured had legal sophistication and substantial relative bargaining power, is not enough.’” (*Martin Marietta Corp. v. Insurance Co. of North America* (1995) 40 Cal. App.4th 1113, 1134, emphasis added; *ibid.* [refusing to depart from the normal rule of interpretation because the insured was “not the author of the coverage provision, which is standard form language adopted by the insurance industry”]; cf. *Garcia v. Truck Ins. Exchange* (1984) 36 Cal.3d 426, 434-435, 438 [holding the rule of construction against insurers did not apply because the specific provisions at issue were **jointly negotiated and drafted**].)

Universal quoted the rule that “[u]nder the doctrine of contra proferentem, any ambiguity in an exclusion is generally construed against the insurer and in favor of the insured” (929 F.3d at p. 1151), but then it proceeded to misapply that rule by ignoring the factual basis underlying holdings reached by the California courts on which it relied.

Departing from over thirty years of settled California law, *Universal* refused to construe the insurance policy’s ambiguous war exclusion in favor of coverage because the policyholder, *Universal*, had “offered” the exclusion. (929 F.3d at p. 1153.) Pointing to *Fireman’s Funds Ins. Co. v. Fibreboard Corp* and *Garcia v. Truck Ins. Exchange*, the Ninth Circuit created a new rule, which is substantially less burdensome on insurers than the rule established by the California Supreme Court in *AIU*: *Universal* held that the presumption in favor of coverage does not apply where there is evidence that the insured proposed or negotiated the policy language at issue, even where the provision was form policy language drafted by insurers. (*Id.* at pp. 1151-1152, citing *Fireman’s Funds Ins. Co. v. Fibreboard Corp.* (1986) 182 Cal.App.3d 462, 467 & *Garcia v. Truck Ins.*

Exchange (1984) 36 Cal.3d 426, 438.) But, *Fireman’s Funds* and *Garcia* do not support *Universal*’s holding and departure from *AIU*, because in both cases the evidence clearly established that the policyholders actually **drafted** the provisions at issue rather than simply proposing language from standard insurance forms. (*Fireman’s Funds*, at p. 468 & fn. 2 [holding there was evidence the insured drafted the provision at issue where the insured’s risk manager testified that he took it upon himself, on his own initiative, to draft the exclusion at issue]; *Garcia*, at pp. 434-435 [discussing the insured’s decision to add the specific provision at issue to address potential exposure to malpractice liability for volunteer staff physicians providing educational services].)

Universal’s outlier holding—i.e., declining to construe policy language against the insurer when the language was offered by the insured—ignores that the exclusions at issue were from a *standard* insurance industry form. (929 F.3d at pp. 1152-1153.) *Universal* misconstrues—and in fact ignores—California law applying the standard set forth in *AIU*, and thus, threatens to erode the protections that the California Supreme Court sought to create for policyholders.

Compounding this error, the Ninth Circuit’s holding ignores the California Fourth Appellate District’s decision in *Coca Cola Bottling Co. v. Columbia Casualty Ins. Co.* (1992) 11 Cal.App.4th 1176, which had strikingly similar facts. There, the insurer attempted to overcome the presumption in *AIU* by arguing the policyholder “had enough negotiating power to put its insurers in the somewhat unusual position of accepting or rejecting policy language **proposed**” by the policyholder. (*Id.* at p. 1185, emphasis added.) Applying *AIU*, *Coca Cola Bottling* held that “an insured’s bargaining position is important and will alter the usual rules of policy interpretation, but only if it can be demonstrated the insured’s bargaining power was brought to bear in **creating** the particular language in dispute.” (*Id.* at p. 1186, emphasis added.) Because the only evidence before the Court of Appeal was that the specific provision was almost identical to language in other policies, the court refused to depart from the normal policy-interpretation rule favoring coverage, even where the evidence clearly showed that the

policyholder “proposed”—or, using *Universal*’s language, “offered”—the language to the insurer. (*Id.* at pp. 1185-1187.) The Ninth Circuit’s failure to consider *Coca Cola Bottling*’s strikingly similar facts and holding inevitably contributed to its misapplication of California law.

Thus, far more pressing than its analysis of war exclusions is the Ninth Circuit’s failure to apply well-established California law in its interpretation of ambiguities in an insurance policy. Although contrary to California law, insurers will no doubt point to *Universal* in an attempt to escape the protections that the California Supreme Court sought to create for policyholders in *AIU*. As an outlier with no binding authority in California state courts, however, *Universal* is anything but “universal” and instead stands athwart the reasoned majority led by the California Supreme Court’s decision in *AIU*.

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