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ALGORITHM FOR CONSTRUCTION OF INSURANCE POLICIES UNDER TEXAS LAW

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MISCELLANEOUS

ALGORITHM FOR CONSTRUCTION OF INSURANCE POLICIES UNDER TEXAS LAW

I. INTRODUCTION

The prospect of insurance policy interpretation and construction is indeed one of the most confused and difficult to apply areas of the law. Many attorneys and courts have misapplied or misconstrued rules of interpretation in construction. This application of misconstruction generally arises from one of two sources. First, courts may look to decisions in other states and apply a decision which has not been followed in Texas. Second, courts may apply rules that have been adopted in Texas but, do not apply the entire rule but rather apply it in a fragmentary fashion. Finally, attorneys may apply rules adopted in Texas, but apply them in the wrong order.[1]

The purpose of this paper is fourfold. First, an attempt will be made to identify the correct rules of policy interpretation in construction under Texas law. No doubt the reader, should he or she desire, be able to go and find case law where there are dissimilar holdings. Again, this is a result of Texas courts applying rules from out of state or applying prior Texas law in a fragmentary fashion. Second, the paper will attempt to explore the foundation for those rules so that the logic can be examined. Third, the paper will attempt to explore some of the practical implications of those rules on the discovery and trial of a coverage case in Texas. Finally, the paper will address the order of the rules to be applied by attorneys and courts in construing insurance policies.

II. CONTRACT RULES OF CONSTRUCTION

Under Texas law, the interpretation of insurance contracts is governed by the same rules of construction applicable to other contracts.[2]

[1] *Nat'l Union Fire Ins. Co. v. Hudson Energy* Co., 811 S.W.2d 552 (Tex. 1991).

[2] *Massey and Fire Insurance Co. v. CBI Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995) ("insurance policies are controlled by Rules of Interpretation and Construction which are applicable to contracts generally."); *Accord, e.g., American Manufacturers Mutual Ins. Co. v. Schaefer*, 124 S.W.3d 154, 157 (Tex. 2003) ("we interpret insurance policies in Texas according to the rules of contract construction."); *Progressive Cty. Mut. Ins. Co. v. Sink*, 107 S.W.3d 547, 551 (Tex. 2003) ("It is well settled that the general rules of contract construction apply to the interpretation of insurance contracts."); *Texas Farmers Ins. Co. v. Murphy*, 996 S.W.2d 873, 879 (Tex. 1999) ("In Texas, insurance contract interpretation is governed by general contract interpretation rules."); *Balandran v. Safeco Ins. Co. Of Am.*, 972 S.W.2d 738, 740-41 (Tex. 1998) ("Insurance contracts are subject to the same rules of construction as other contracts."); *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994) ("Interpretation of insurance contracts in Texas is governed by the same rules as interpretation of other contracts."); *Nat'l Union Fire Ins. Co. v. Hudson Energy* Co., 811 S.W.2d 552, 555 (Tex. 1991) ("Generally, a contract of insurance is subject to the same rules of construction as other contracts."); *Western Reserve Life Ins. Co. v. Meadows*, 152 Tex. 559, 261 S.W.2d 554, 557 (1953) ("It's the settled law in this state that contracts of insurance and

It is this step, where most courts who go astray, begin their erroneous journey. One commentator has identified two primary approaches to policy interpretation. The first is entitled "legal formalism." Under this approach, an insurance policy should be interpreted according to traditional contract interpretation principles.[3] Under the legal formalism approach, courts would apply the traditional rules of contract interpretation found in the Restatement of the Law of Contracts[4] or in Professor Williston's well known contract law treatise.[5]

The second approach has been termed the "legal functionalism" approach.[6] Under the legal functionalism approach, courts would apply specialized, and usually pro-coverage, rules of policy interpretation. The purpose of these rules arguably is to achieve "fair" results. The courts take into account the relative bargaining position and disparities of the parties. The genesis of this second approach may be found in the "reasonable expectations" doctrine espoused by Professor Keeton.[7] Under this approach, the "objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."[8]

Texas, without question, follows the legal formalism approach. However, at least, one opinion of the Supreme Court has suggested that while the court is articulating the legal formalism approach, it is applying the legal functionalism approach.[9] It is with this understanding that any approach to an interpretation and construction of an insurance policy must begin. It is at this point where many courts and many attorneys have erred in the initiation of their analysis.

The rule followed by Texas courts today appear for the first time in its present form in *Hall v. Mutual Benefit Health & Accident*

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their construction are governed by the same rules as other contracts, and that terms used in them are to be given their plain, ordinary and generally accepted meaning unless the instrument itself shows them to have been used in a technical or different sense.")

[3]Peter Swisher, *Traditional Interpretation of Insurance Contract Disputes: Toward a Realistic Middle Ground Approach*, 57 OHIO ST. L. J. 543, 559 (1996)

[4]Restatement (Second) of Contracts (1981)

[5]Samuel Williston, *The Law of Contracts* (1921); Samuel Williston, *A Treatise on the Law of Contracts* (W. Jaeger 3rd Ed. 1957-78 and sup. 1995).

[6]Peter Swisher, *Judicial Interpretations of Insurance Contract Disputes: Toward a Realistic Middle Ground Approach*, 57 OHIO ST. L. J. 543, 559 (1996).

[7]Robert Keeton, *Ins. Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970) (Part I) and 83 HARV. L. REV. 1281 (1970) (Part II).

[8]*Id.*.

[9]*Utica Nat'l Ins. Co. of Texas v. Am. Indemnity Co.*, 141 S.W.3d 198, 206 (Tex. 2004).

Ass'n,[10] This case involved an air travel accident policy and raised the issue of the construction to be given to the term "powered aircraft." The court there said that, "The terms of an insurance policy must be interpreted in light of common sense. Notwithstanding the rule that contracts of insurance are to be strictly construed in favor of the insured, it is well settled that the insurance contracts, in common with other contracts, are to be construed according to the sense and meaning of the terms used by the parties. If clear and unambiguous and free from fraud, accident, or mistake, it is conclusively presumed that the parties intended to give the terms used their plain, ordinary and accepted meaning."[11]

Within a few years, this language had been adopted by the Texas Supreme Court in *Aetna Life Ins. Co. v. Reed*.[12] This case involved the construction of a life insurance policy. The court there held that, "we think the intent of the parties and the use of the language is unmistakable, therefore, but we cannot give it an opposite meaning under any theory of ambiguity.[13]

A year later, the Supreme Court once again reaffirmed this position in *Western Life Ins. Co. v. Meadow*.[14] This case involved the construction of the term "war" as used in a life insurance policy. The court there held that, "it is well settled law in this state that contracts of insurance in their construction are governed by the same rules as other contracts, and that the terms used in them are to be given their plain, ordinary and generally accepted meanings unless the instrument itself shows them to have been used in a technical or different sense."[15] Since this decision, the Texas Supreme Court has adhered to this rule, refusing invitations to move over to the "legal functionalism" approach. Most of the rules of interpretation and construction followed by Texas courts derive their source from the rules set forth in the *Hall* case. However, the rules that have been adopted in Texas since *Hall* are not without certain order. The ordering of the application of these rules has been addressed by our supreme court on more than one occasion. Nevertheless, in applying the rules, many courts have failed to follow this order. Even if the correct rules are applied, if the order is not followed, it can lead to an incorrect result. This paper will examine not only the rules that have been adopted by Texas but, more importantly, the order in which the rules should be applied to arrive at a proper construction and interpretation.

III. STEP #1 - PLAIN MEANING RULE

[10] *Hall v. Mutual Benefit Health & Accident Ass'n*, 220 S.W.2d 934, 936 (Tex. Civ. App.–Amarillo 1949, writ ref'd)

[11] *Id.* (Citations omitted).

[12] 151 Tex. 396, 251 S.W.2d 150 (Tex. 1952).

[13] *See Hall v. Mutual Benefit Health & Accident Ass'n*, Tex. Civ. App., 220 S.W.2d 934 (1949), error refused, for an admirable statement of the rules of construction applicable here.

[14] 152 Tex. 559, 261 S.W.2d 554 (Tex. 1953).

[15] *Id.* at 564. (Citing *Hall v. Mutual Benefit Health & Accident Ass'n*, Tex. Civ. App., 220 S.W.2d 934, 936, application for writ of error refused.")

The first step in construing insurance policies is to start with the plain meaning rule. Under the plain meaning rule, the court is to apply, only with certain exceptions, the plain meanings of the words used in the specific provisions. If after the application of the plain meaning of the policy language there can be given a specific or definite legal meaning or interpretation, then the provision is unambiguous and the court will interpret it as a matter of law.[16]

A. Standard of Review –Step #l

The standard of review or primary concern of a court in construing a written contract is to ascertain the true intent of the parties as expressed in the instrument.[17] Therefore, based upon the foregoing, the Supreme Court has clearly indicated that the primary goal in reviewing a policy is to give effect to the written expression of the parties' intent. There are several caveats with that expression, however. First, it is the primary goal. There are other goals which must be followed by the court as it construes a policy. These other goals will be addressed in the paragraphs following.

Second, the goal is to give effect to the "written expression" of the parties' intent. The scope of review will be addressed in the next paragraph; however, because the parties have entered into a written contract, the court is to focus on the written language in the contract. If the court were allowed to focus on the parties' oral expressions of their intent, then the purpose of a written contract would be defeated. Moreover, most insurance policies do have merger clauses and the legal effect of the merger clauses would likewise be defeated.

Finally, the focus is to be on the "parties' intent." The focus should not be solely upon the intent of the insured or the expectations of the insured. Rather, the focus should be on the intent of both parties to the contract and what was intended by both parties as they entered into the contract.

B. Rules of Interpretation Governing Step #1

[16] *Texas Farm Bureau Mut. Ins. Co. v. Sturrock*, 146 S.W.2d 123, 126 (Tex. 2004).

[17] *Utica Nat'l Ins. Co. of Texas v. Am. Indemnity Co., Inc.*, 141 S.W.3d 198, 202 (Tex. 2004) ("The primary concern of a court in construing a written contract is to ascertain the true intent of the parties as expressed in the instrument."); *Progressive County. Mut. Ins. Co. v. Sink*, 107 S.W.3d 547, 551 (Tex. 2003) ("In general, a court construing a contract 'must strive to give effect to the written expression of the parties' intent.'"); *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. CBI Industries*, 907 S.W.2d 517, 520 (Tex. 1995) ("The primary concern of a court in construing a written contract is to ascertain the true intent of the parties as expressed in the instrument."); *State Farm Life Ins. Co. v. Beastin*, 907 S.W.2d 430, 433 (Tex. 1995) ("When construing a contract, courts must strive to give effect to the written expression of the parties' intent."); *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994) (" When construing a contract, the court's primary concern is to give effect to the written expression of the parties' intent."); *Tex. Farmers Ins. Co. v. Murphy*, 996 S.W.2d 873, 879 (Tex. 1999) ("Our goal is to give effect to the written expression of the parties' intent."); *Balandran v. Safeco Ins. Co. of America*, 972 S.W.2d 738, 740 (Tex. 1998) ("Our primary goal, therefore, is to give effect to the written expression of the parties' intent.").

The Texas Supreme Court has set forth several rules of interpretation that are to govern the initial interpretation of an insurance policy. These rules are to be applied initially to determine whether there is more than one interpretation for the policy provision. Each rule is important and none should be ignored.

1. Entire Contract

First and foremost, the person interpreting the policy must read all parts of the contract together.[18] Under this rule, a court may not focus on just one part of the policy and ignore other portions. To do this would defeat the intent of the parties by including all provisions of the policy in the contract.

2. Meaning to Each Word

Under this rule, the court really must view all portions of the policy, but when dealing with a specific portion of a policy, must strive to give meaning to every sentence, clause, and word to avoid rendering any portion inoperative.[19] Under this rule, when dealing with a specific section of the policy, the court must give meaning not only to every sentence, but to every word in order to see that the intent of the parties, as reflected in the written instrument, is expressed in the construction given by the court.

3. Isolation

A corollary to the prior rules is the rule regarding isolation. Courts must be particularly wary of isolating from its surrounding or considering apart from other provisions a single phrase, sentence, or section of a contract.[20]

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[18] *Am. Manufacturers Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 157 (Tex. 2003) ("When construing the policy's language, we must give effect to all contractual provisions so that none will be rendered meaningless."); *Progressive Mut. Ins. Co. v. Sink*, 107 S.W.3d 547, 551 (Tex. 2003) ("In general, a court construing a contract 'must strive to give effect to the written expression of the parties' intent' by 'reading all parts of the contract together.'"); *Tex. Farmers Ins. Co. v. Murphy*, 996 S.W.2d 873, 879 (Tex. 1999) ("We generally "strive to give meaning to every sentence, clause, and word to avoid rendering any portion inoperative."); *Balandran v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex. 1998) ("We must read all parts of the contract together."); *State Farm Life Ins. Co. v. Beastin*, 907 S.W.2d 430, 433 (Tex. 1995) ("To do so, they must read all parts of a contract together."); *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994) ("This court is bound to read all parts of a contract together to ascertain the agreement of the parties.").

[19] *Tex. Farmers Ins. Co. v. Murphy*, 996 S.W.2d 873, 879 (Tex. 1999) ("We generally 'strive to give meaning to every sentence, clause and word to avoid rendering any portion inoperative.'");*Balandran v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex. 1998) ("Striving to give meaning to every sentence, clause, and word to avoid rendering any portion inoperative."); *see United Services Automobile Ass'n v. Miles*, 139 Tex. 138, 161 S.W.2d 1048, 1050 (1942).

[20] *State Farm Life Ins. Co. v. Beastin*, 907 S.W.2d 430, 433 (Tex. 1995) ("Indeed, courts must be particularly wary of isolating from its surroundings or considering apart from other provisions a single phrase, sentence, or section of a contract."); *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133-34 (Tex. 1994) ("This is an application of our long-established rule that 'no one phrase, sentence, or section [of a contract] should be isolated from its setting and considered apart from the other provisions.'").

4. Absurd Meaning

The fourth rule which must be followed in the initial interpretation of an insurance policy how to interpret in such a way as to render the meaning absurd.[21]

Again, the goal in this initial interpretation is to ascertain the true intent of the parties as expressed in the written instrument. To render a term absurd would be contrary to this initial goal.

5. Redundant Meaning

A corollary to the previous rule is that no interpretation should be rendered that would make certain words redundant. In other words, each different word should have its own meaning.[22]

C. Meaning to Be Given to Words

One issue frequently faced by courts is the source of meaning to be given to words. At least two different rules have evolved in order to identify the definitions to be given to words as used in insurance contracts.

1. Definition Rule

The first rule is the "definition" rule. Where the policy, by its own terms, defines a term, those definitions control.[23] The logic behind this rule is simple. Where the parties have agreed upon a definition and have included that definition in the contract, the court should not substitute a definition different from that agreed to by the parties. Even if a definition is itself unreasonable or does not reflect the intent of one of the parties, that definition will control because it was a definition that the parties elected to include in the contract.

2. Plain Ordinary Meaning Rule

Where the contract contains no definition, a different rule applies. Where the policy does not define a term, then the court will look for the ordinary, everyday meaning of the words to the general public dictionary.[24] Texas courts have used the ordinary, everyday meaning of the words to the general public dictionary for the reason that, with respect to most policies, the actual language used in the policy would not reflect the intent of either the insured or the insurer. Texas insurance is highly regulated by the Department of Insurance. As a result, the actual intent

[21] *Southern Farm Bureau Cas. Ins. Co. v. Adams,* 570 S.W.2d 567 (Tex.Civ.App.–Corpus Christi 1978 (writ ref'd n.r.e.).

[22] *Id.*

[23] *Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 216 (Tex. 2003); Ramsey v. Maryland Am. Gen'l Ins. Co., 533 S.W.2d 344, 346 (Tex. 1976); *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997) ("And when terms are defined in an insurance policy, those definitions control.").

[24] *Progressive County. Mut. Ins. Co. v. Sink*, 107 S.W.3d 547, 551 (Tex. 2003) ("We look to the term in the ordinary, everyday meaning of the words to the general public."); *United States Ins. Co. of Waco v. Boyer*, 153 Tex. 415, 269 S.W.2d 340, 341 (1954) (In construing such policies, we look to determine the ordinary, everyday meaning of the words to the general public.)

involved and the precise words are as much or more the intent of the Department of Insurance which prescribes the wording of the policy as it is the intent of the parties. In Texas, it is unlawful to issue many policies in words other than those expressly approved by the Department of Insurance and in certain lines of insurance, every insurance company selling this line is required to word its policies precisely alike. Uniform policies are necessary to a uniform rate structure, which in turn resulted from the public injury caused by highly competitive wildcat insurance schemes. Therefore, a true search for what the courts usually speak of as the intent of parties would not be an inquiry as to what the words of the contract meant to a particular insurer or insured, but rather, what the intent was to the Department of Insurance.[25]

3. Technical Meaning Rule

The court is also authorized to depart from the ordinary and accepted meaning to contract terms if the policy shows that the words were meant in a technical or different sense.[26] In many instances, particularly professional errors and omissions policies, the intended application of the policy is to apply to a fairly technical activity or product. In those occasions where the policy is clearly intended to apply to a fairly technical activity or product, then the technical meanings associated with that activity or product will govern the interpretation of the policy.

4. Contrary to Intent of Parties

However, it should be noted that at least once case has held that the language used by the parties in a contract should be accorded its plain, grammatical meaning except if it becomes apparent that the intention of the parties would so be defeated.[27] This rule apparently would require that the intent of both parties would be defeated by the application of plain, grammatical meaning before a court could resort to other language.

D. Resolution of Step #1

If after applying the rules regarding the meaning of words in reviewing the policy in its entirety the parties intent is clearly expressed by the written instrument, the interpretation of the policy stops at this point in time. There is no need to review any further evidence or to engage in any further rules of construction.

However, if there is more than one interpretation present, the person making such an analysis should proceed to Step #2.

Assuming there are more than one interpretation, the next step is to determine if the policy is ambiguous. In determining whether or not a policy is ambiguous, it is also

[25] *Progressive County. Mut. Ins. Co. v. Sink*, 107 S.W.3d 547, 551-52 (Tex. 2003).

[26] *American States Ins. Co. v. Hanson Industries*, 873 F. Supp. 17, 22 (S. D. Tex 1995); *Security Casualty Co. v. Johnson*, 584 S.W.2d 703, 704 (Tex. 1979).

[27] *Lyons v. Montgomery*, 701 S.W.2d 641, 643 (Tex. 1985).

helpful to know when a policy is unambiguous.

IV. STEP #2 – DETERMINE IF AMBIGUOUS – QUESTION OF LAW

A. When Policy is Unambiguous

If a contract as written "can be given a definite or certain legal meaning," then it is unambiguous as a matter of law.[28] The remaining question then presented is what is a "definite or certain" legal meaning. What is "definite or certain" to one person may not be "definite or certain" to another. However, where the written document as a whole indicates the parties intended a specific meaning, then the contract is "definite or certain." In addition, Texas courts have specifically limited what can be done by a party to create ambiguity.

1. Parol Evidence

Texas courts are quite clear that a court may not consider parol evidence in order to create an ambiguity. As stated earlier, to allow parol evidence to create ambiguity would violate the sanctity of the written contract as well as the terms of the merger clause.[29]

2. Rules of Construction

If a policy is unambiguous, the court cannot resort to the various rules of construction.[30]

3. Differing Interpretations do not Create an Ambiguity

An ambiguity does not arise merely because the parties offer differing interpretations of the policy language.[31] The reason for this is that in most, if not every case, the insured and the insurer are likely to take conflicting views of coverage. That is the essence of a coverage dispute. However, neither conflicting expectations nor disputation is sufficient to create an ambiguity.[32]

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[28] *Progressive Mutual Ins. Co. v. Sink*, 107 S.W.3d 547, 551 (Tex. 2003); *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997); *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983).

[29] *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. CBI Industries, Inc.*, 907 S.W.2d 517, 521 (Tex. 1995).

[30] *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 665 (Tex. 1987) ("However, if the insurance contract is expressed in plain and unambiguous language, a court cannot resort to the various rules of construction.").

[31] *Texas Farm Bureau Mut. Ins. Co. v. Sturrock*, 146 S.W.3d 123, 126 (Tex. 2004); *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 463, 465 (Tex. 1998); *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 134 (Tex. 1994).

[32] *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 134 (Tex. 1994); *Preston Ridge Financial Services v. Tyler*, 796 S.W.2d 772, 777 (Tex. App.–Dallas (1990), writ denied); *Medical Towers v. St. Luke's Episcopal Hosp.*, 750 S.W.2d 820, 822 (Tex.

4. Lack of Clarity

Texas courts have also held that an uncertainty or lack of clarity in the language chosen by the parties to the insurance contract is also insufficient to render the contract ambiguous.[33] The fact that the court may have to search for the proper definition of a term is part of its job in construing the policy.[34]

B. Ambiguity is a Matter of Law for Courts

Without question, the issue of whether or not a contract is ambiguous is a question of law for the court.[35] As a result, the issue of whether or not a policy is ambiguous is not something which would ever be submitted to a jury nor would it be something that would be addressed in findings of fact in a trial before the court. As a result, when the question of ambiguity is reviewed on appeal by
an appellate court, it is not reviewed under a sufficiency of evidence standard, but rather would be reviewed *de novo* as would any other question of law. Contract interpretation, including the question of whether a contract is ambiguous is a question of law subject to de novo review.[36]

C. Evidence Which May Not Be Considered

In making a determination of whether or not a policy is ambiguous, there is certain evidence which the trial court may not use in order to create ambiguity. First, a court cannot use parol evidence in order to create the ambiguity.[37] In addition, a court may not use the fact that the parties have differing interpretations of the policy to create an ambiguity.[38] The reason for this is that in practically every case, the insured and the insurer are likely to take conflicting views of coverage. However, neither conflicting expectations nor disputation is sufficient to create an ambiguity.[39]

App.–Houston [14th Dist.] 1988, writ denied).

[33] *Hofland v. Fireman's Fund Ins. Co.*, 907 S.W.2d 597 (Tex. App.–Corpus Christi 1995, no writ).

[34] *See* section V, *infra*.

[35] *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. CBI Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983); *R & P Enterprises v. La Guarta, Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 518 (Tex. 1980).

[36] *Instone Travel Tech Marine & Offshore v. International Shipping Partners, Inc.*,, 334 F.3d 423, 428 (5th Cir. 2003); *Blakely v. State Farm Mut. Auto Ins. Co.*, 406 F.3d 747, 750 (5th Cir. 2005); *Canutillo Indep. Sch. Dist. v. Nat'l Union Fire Ins. Co.*, 99 F.3d 695, 700 (5th Cir. 1996).

[37] *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. CBI Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995).

[38] *Texas Farm Bureau Mutual Ins. Co. v. Sturrock*, 146 S.W.3d 123, 126 (Tex. 2004); *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 462, 465 (Tex. 1998); *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 134 (Tex. 1994).

[39] *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d at 133.

D. Evidence Which May Be Considered

One of the most difficult determinations in policy interpretation and construction is what evidence may be considered initially to determine whether the policy is or is not ambiguous. This issue is difficult for one primary reason. That reason is that Texas allows certain evidence to be considered on the issue of whether the policy is ambiguous. Once the policy has been determined to be ambiguous, then a different set of evidence is allowed by Texas courts to attempt to resolve the ambiguity. Courts often are tempted to mix and match the types of evidence without regard to the stage of the policy interpretation and construction that is involved.

With respect to the initial determination of whether a policy is or is not ambiguous, only limited evidence may be considered. In subsection C, it was discussed what evidence may not be considered in determining whether a policy was ambiguous. In order to determine whether a policy is ambiguous, the courts have held that the contract may be read in light of the surrounding circumstances to determine whether an ambiguity exists.[40] The surrounding circumstances which may be considered likewise are limited. If circumstances that exists at the time of the loss is irrelevant. Rather, it is only those circumstances present when the contract was entered that may be considered.[41]

E. Existence of Ambiguity

Texas courts have been quite consistent with what test is to be applied to determine whether a policy is ambiguous. A policy will be deemed to be ambiguous only if the contract is susceptible to two or more reasonable interpretations.[42] As stated earlier,

[40] *Balandran v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex. 1998) ("The contract may be read in light of the surrounding circumstances to determine whether an ambiguity exists.") *See also, Columbia Gas Transmission Corp. v. New Ulm Gas*, 940 S.W.2d 587, 589 (Tex. 1996); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Industries*, 907 S.W.2d 517, 520 (Tex. 1995).

[41] *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455 (Tex. 1997). ("Whether a contract is ambiguous is a question of law that must be decided by examining the contract as a whole in light of the circumstances present when the contract is entered."); *Columbia Gas Transmission Corp. v. New Ulm Gas*, 940 S.W.2d 587 (Tex. 1996); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995).

[42] *Texas Farm Bureau Mut. Ins. Co. v. Sturrock*, 146 S.W.2d 123, 126 (Tex. 2004) ("An ambiguity exists only if the contract is susceptible to two or more reasonable interpretations."); *American Manufacturers Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 157 (Tex. 2003). ("An ambiguity exists only if the contract language is susceptible to two or more reasonable interpretations."); *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997) ("Conversely, if an insurance contract is subject to more than one reasonable interpretation, the contract is ambiguous."); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995) ("If, however, the language of the policy or contract is subject to two or more reasonable interpretations, it is ambiguous."); *State Farm Fire & Casualty Co. v. Reed*, 873 S.W.2d 698, 699 (Tex. 1993) ("However, if the contract is susceptible to more than one reasonable interpretation, we must resolve the uncertainty by adopting the construction most favorable to the insured."); *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 665 (Tex. 1987) ("It has long been the law

just because a policy may be susceptible to two interpretations does not render the policy ambiguous.[43] Rather, for a policy will be deemed to be ambiguous, it must be susceptible to two "reasonable" interpretations. It is at this stage that many courts and many attorneys stop the analysis and concluded that because there are two interpretations of the policy, the policy is ambiguous. However, the Texas Supreme Court has clearly ruled that only after going through further analysis can one determine whether both interpretations are indeed "reasonable."

V. STEP #3 - APPLICATION OF RULES OF CONSTRUCTION

Once it is determined that there are two interpretations, the first step in determining whether both interpretations are reasonable is to apply the rules of construction. The source of this rule lies with a non-insurance case. This rule was originally announced in *Universal C.I.T. Credit Corp. v. Daniel*.[44] In *Universal C.I.T.*, the court held that:

> In a fairly recent case, this court said that "if a written contract is so worded that it can be given a certain or definite or legal meaning or interpretation, it is not ambiguous." The converse of this is that a contract is ambiguous only when the application of pertinent rules of construction of interpretation to the face of the instrument leaves it genuinely uncertain which one of two or more meanings is the proper meaning. In other words, if after applying established rules of interpretation to the contract it remains reasonably susceptible to more than one meaning it is ambiguous, but if only one reasonable meaning clearly emerges it is not ambiguous. In the latter event the contract will be enforced as written and parol evidence will not be received . . . .[45]

The Texas Supreme Court has likewise adopted this rule for interpretation of insurance contracts. For example, in *State Farm Life Ins. Co. v. Beaston*,[46] the Supreme Court held that:

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in this state that when language in a policy is susceptible to more than one reasonable construction, it is patently ambiguous."); *Blaylock v. American Guarantee Bank Liability Ins. Co.*, 632 S.W.2d 719, 721 (Tex. 1982) ("However, when the language used is subject to two or more reasonable interpretations, construction which supports coverage will be adopted."); *Glover v. Nat'l Ins. Underwriters*, 545 S.W.2d 755 (Tex. 1977).

[43] *Texas Farm Bureau Mut. Ins. Co. v. Sturrock*, 146 S.W.3d 123, 126 (Tex. 2004) ("An ambiguity does not arise simply because the parties offer conflicting interpretations of the policy language.").

[44] 243 S.W.2d 154 (Tex. 1951).

[45] *Id.* at 157 (Citations omitted).

[46] 907 S.W.2d 430 (Tex. 1995).

> Only if an insurance policy remains ambiguous despite these canons of interpretation should courts construe its language against the insurer in a manner that favors coverage.[47]

The corollary to this rule is that if one interpretation does not comport with the rules of construction, it is not reasonable.[48]

The rules of construction that govern insurance contracts are needed. They will be addressed below:

A. <u>*Ejusdem Generis*</u>

One of the first rules of construction is the rule of *Ejusdem Generis*. According to the supreme court:

> When specific and particular enumerations of things . . . are followed by general words, the general words are not to be construed in their widest meaning or extent, but are to be treated as limited and applying only to the persons or things of the same kind or class as those expressly mentioned.[49]

The rule of *ejusdem generis* provides that, when words of a general nature are used in connection with the designation of particular objects or classes of persons or things, the meaning of the general words will be restricted to the particular designation.[50] The term "*ejusdem generis*" is a primary rule of construction. Where words of general nature follow, or are used in connection with the designation of particular objects or classes of persons or things, the meaning of the general words will be restricted to the particular designation. "General words are not to be construed in their widest meaning or extent, but are to be treated as limited and applying only to persons or things of the same kind or class as those expressly mentioned."[51]

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[47] *Id.* at 433.

[48] *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 666 (Tex. 1987) ("This is against the fundamental rule that each part of the contract should be given effect when it will not do violence to the rules of law or construction.").

[49] *Id. Stamford v. Butler*, 142 Tex. 692, 181 S.W.2d 269, 272 (1944).

[50] *Hilco Elec. Coop., Inc. v. Midlothian Butane Gas Co.*, 111 S.W.3d 75, 81 (Tex. 2003).

[51] *Stanford v. Butler*, 181 S.W.2d 269, 272 (Tex. 1944).

B. Endorsements

Under Texas law, an endorsement cannot be read apart from the main policy and all the provisions will supersede previous terms to the extent they are truly in conflict.[52] It is only in cases of conflict that endorsement to a policy prevails over an inconsistent printed provision of the policy.

C. Specific Over General

In addition, general terms will be controlled by specific provisions. Where there is a special provision of the policy, as a special provision it will control over more general provisions contained within the text of the policy.[53]

D. Manuscript over Printed

It has been and continues to be the rule in Texas that written or manuscript provisions control over printed provisions, but only to the extent that they cannot be reconciled.[54] Even though the parties will often begin with a preprinted or standard form contract, they will sometimes make changes which may be handwritten, but then it may also be typed. In accordance with the general rule that all parts of a contract are to be given effect, the courts will seek to reconcile inconsistencies between the written and printed matter.[55] Where, however, the printed contract provisions irreconcilably conflict with the written provisions added by the parties, the written provision will control.[56]

E. Later Endorsement Supersedes Early Endorsement

A later endorsement in an insurance policy supercedes an early endorsement to the extent of any inconsistencies.[57] A rider attached to an insurance policy merges into the policy and should be treated as part of it. When the

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[52]*Primrose Operating Co. v. Nat'l American Ins. Co.*, 382 F.3d 546 (5th Cir. 2004);*Westchester Fire Ins. Co. v. Heddington Ins.*, 84 F.3d 432 (5th Cir. 1996); *U. E. Texas One-Barrington v. General Star Indem. Co.*, 243 F.Supp.2d 652, 661 (W.D. Tex. 2001); *Mace Operating Co. v. California Union Ins. Co.*, 986 S.W.2d 749, 754 (Tex.App.–Dallas 1999).

[53]*Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d at 133-46 (Tex. 1994); *Davis v. Texas Life Ins. Co.;* 426 S.W.2d 260 (Tex.App.–Waco 1968, writ ref'd n.r.e.); *Kuntz v. Spence*, 67 S.W.2d 254 (Tex. 1934).

[54]*Georgia Home Ins. Co. v. Jacobs*, 56 Tex. 366 (1882); *Constitution Indemnity Co. v. Armbrust*, 25 S.W.2d 176 (Tex.App.–1930, writ ref'd); *McMahon v. Christmann*, 303 S.W.2d 342 (Tex. 1957); *Tapatio Springs Builders, Inc. v. Maryland Cas. Ins. Co.*, 82 F.Supp.2d 633, 641 (W.D. Tex. 1999); *Fidelity-Phoenix Fire Ins. Co. v. Farm Air Service*, 255 F.2d 658 (5th Cir. 1953); *Rainy v. Uvalde Producers Rural Mohair Co.*, 571 S.W.2d 199, 201 (Tex.App.–San Antonio 1978, writ ref'd n.r.e.); *Scogin v. Camp*, 556 S.W.2d 850, 852 (Tex.Civ.App.–Corpus Christi 1977, writ ref'd n.r.e.).

[55]*Roylex Inc. v. Avco Community Developers, Inc.*, 559 S.W.2d 833 (Tex.App.–Houston [14th Dist.] 1977).

[56]*Montgomery Ward & Co. v. Dalton*, 665 S.W.2d 507 (Tex.App.–El Paso 1983); *see also Constitution Indemnity Co. of Philadelphia v. Armbrust*, 25 S.W.2d 176 (Tex.App.–1930, writ ref'd).

[57]*INA of Texas v. Leonard*, 714 S.W.2d 414 (Tex.App.–San Antonio 1986, writ ref'd n.r.e.).

provisions of the rider are more specific than those in the policy, the rider controls.[58]

F. Captions

A court may resort to the caption of a provision to explain the apparent ambiguity in the provisions, but may not use a caption to create one.[59]

G. Exceptions Over General Provisions

It is also the rule in Texas that exceptions will prevail over general provisions in an insurance policy.[60]

H. *Nocitur a Sociis*

Another rule of construction is the maxim of *nocitur a sociis*. Generally, this term means that a word is known by the company it keeps.[61] *Nocitur a sociis* is a rule often applied so that the meaning of a doubtful word may be ascertained by reference to the meaning of the words associated with it.[62] Justice Steakley discussed the maxim *nocitur a sociis* in the context of statutory construction and said the following:

> [T]he meaning of particular terms in a statute may be ascertained by referenced to words associated with them in the statute; and that where two or more words of analogous meaning are employed together in a statute, they are understood to be used in their cognate sense, to express the same relations and give color and expression to each other.[63]

Noscitur a sociis simply dictates that "the coupling of words together shows that they are to be understood in the same sense. And, where the meaning of any particular word is doubtful or obscure, the intention of the party who has made use of it may frequently be ascertained and carried unto effect by looking at the adjoining words."[64] *Ejusdem generis*, on the other hand, proposes that when "particular words of description are followed by general terms the latter will be regarded as referring to things of a like class with those particularly described."[65] Both canons are useful means of clarifying ambiguous

[58] *American General Fire & Cas. Co. v. Buford*, 716 S.W.2d 86 (Tex.App.–Austin 1986, writ ref'd n.r.e.).

[59] *Amicable Life Ins. Co. v. Slaughter*, 288 S.W.2d 533, 535 (Tex.Civ.App.–Austin 1956, writ dismissed).

[60] *Celestino v. Mid-American Indemnity Ins. Co.*, 883 S.W.2d 310 (Tex.App.–Corpus Christi 1994, writ denied).

[61] *SMI Realty Mgmt. Corp. v. Underwriters at Lloyds London*, ____ S.W.3d ___ (Tex.App–Houston [1st Dist.] 2005).

[62] *Farmers and Mechanics Nat'l Bank v. Hanks*, 104 Tex. 320, 137 S.W. 1120, 1124 (1911).

[63] *County of Harris v. Eaton*, 573 S.W.2d 177, 181 (Tex. 1978) (Steakley, J., dissenting).

[64] *Neal v. Clark*, 95 U.S. 704 (1877).

[65] *U. S. v. Mescall*, 215 U.S. 26, 31, 30 S.Cut. 19, 54 L.Ed. 77 (1909).

statutory language.[66] With respect to *noscitur a sociis*, "[t]hat a word may be known by the company it keeps is . . . not an invariable rule, for the word may have a chracter of its own not to be submerged by its association."[67]

I. Definitions Control Over Plain Language

When the terms used in an insurance policy are defined, those definitions will control over the ordinary meaning of the language.[68]

In Step #3, both interpretations should be tested against the rules of construction. If one interpretation runs afoul the rules of construction, it is not reasonable under Texas law.[69] If after the application of the rules of construction there is only one reasonable interpretation, the inquiry stops at this point. The party whose interpretation is consistent with the rules of construction is entitled to have his or her interpretation adopted. However, if both interpretations comply with the rule of construction, the parties must progress to Step #4.

[66]*Doyle v. State*, 148 S.W.3d 611 (Tex.App.–Austin 2004).

[67]*Russell Motor Car Co. v. United States*, 261 U.S. 514, 519 (1923).

[68]*Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1999) ("And when terms are defined in an insurance policy, those definitions control."); *see, e.g., Ramsay v. Maryland Am. Gen. Ins. Co.*, 533 S.W.2d 344, 346 (Tex. 1976).

[69]*Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 666 (Tex. 1987).

VI. STEP #4 - EXTRINSIC EVIDENCE

If there are two interpretations which comply with the rules of construction, the court must proceed to the next step, which is the use of extrinsic evidence. Texas courts have long recognized the use of extrinsic evidence to resolve an ambiguity.[70]

A. Extrinsic Evidence Not Used To Create Ambiguity

Texas law has consistently held to the proposition that courts cannot use extrinsic evidence to prove the existence of, or create an ambiguity.[71] Therefore, extrinsic evidence, including parol evidence, is not admissible for the purposes of creating an ambiguity, but only becomes admissible once there has been a determination by the court that an ambiguity exists.

B. Patent and Latent Ambiguity

[70]*United Founders Life Ins. Co. v. Carey*, 363 S.W.2d 236, 241-43 (Tex. 1962).

[71]*Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 463, 464 (Tex. 1998) ("Parol evidence is not admissible for the purposes of creating an ambiguity."); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. C.B.I. Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1994) ("Parol evidence is not admissible for the purpose of creating an ambiguity."); *see also Universal C.I.T. Credit Corp. v. Daniel*, 243 S.W.2d 154, 157 (Tex. 1951) ("In the latter event the contract will be enforced as written, parol evidence will not be received for the purpose of creating an ambiguity or to get the contract meaning different from that which its language imports."); *Lewis v. East Texas Finance Co.*, 136 Tex. 149, 146 S.W.2d 977, 980 (1941).

Texas law recognizes at least two different types of ambiguities. An ambiguity in a contract may be either "patent" or "latent." A patent ambiguity is evidence on the face of the contract.[72] Another type of ambiguity is when, on the face of the document, there is more than one reasonable interpretation. In that event, the policy may be said to have a "patent" ambiguity.

On the other hand, a latent ambiguity arises when a contract which is unambiguous on its face is applied to the subject matter with which it deals and an ambiguity appears by reason of some collateral matter.[73] The supreme court gave an example of a latent ambiguity in the *CBI* opinion. For example, if the contract called for the goods to be delivered to "the green house on Pecan Street" and there were in fact two green houses on the street, it would be latently ambiguous.

C. Types of Extrinsic Evidence Admissible

There is no limit on the type of extrinsic evidence which may be admissible. Here the court may consider the parties' interpretation.[74] In addition, the court may admit other types of extrinsic evidence to determine the true meaning of the instrument.[75] Other extrinsic evidence may include evidence regarding trade usage.[76] In addition, evidence of the intent of the parties may be found in the documents leading up to the issuance of the policy which would include the underwriting file, the broker's file, as well as the insured's file. Other courts have resorted to drafting information from ISO as well as filings by the carrier with the Texas Department of Insurance.[77]

However, in *Progressive County Mutual Ins. Co. v. Sink*,[78] the court refused to determine the actual intent of the parties because it stated that "when the policy forms are mandated by a state regulatory agency, the actual intent of the parties is not material" to

[72]*Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. C.B.I. Industries, Inc.*, 107 S.W.2d 517, 520 (Tex. 1995); *Universal Home Builders, Inc. v. Farmer*, 375 S.W.2d 737, 742 (Tex.Civ.App.–Tyler 1964, no writ).

[73]*Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. C.B.I. Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *Murphy v. Dilworth*, 137 Tex. 32, 151 S.W.2d 1004 (1941); *see Bache Halsey Stuart Shields, Inc. v. Alamo Savings Assoc. of Texas*, 611 S.W.2d 706, 708 (Tex.Civ.App.–San Antonio 1980, no writ).

[74]*Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. C.B.I. Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *Sun Oil Co. v. Madeley*, 626 S.W.2d 726, 732 (Tex. 1981).

[75]*C.B.I. Industries, Inc.*, 907 S.W.2d at 520; *R & P Enterprises v. LaGuarta, Gavrel & Kirk*, 596 S.W.2d 517, 518 (Tex. 1980).

[76]*C.B.I. Industries, Inc.*, 907 S.W.2d at 522.

[77]*Union Pacific Resources Co. v. Aetna Cas. & Sur. Co.*, 894 S.W.2d 401, 405 (Tex.App.–Fort Worth 1994, writ denied).

[78]107 S.W.3d 547, 551 (Tex. 2003).

construe the contract.[79] The insurance policy at issue in *Sink* was the Texas Personal Auto Policy as mandated by the Texas Department of Insurance.[80] The Texas Supreme Court referred to its prior holding in *United States Ins. Co. of Waco v. Boyer*,[81] holding "that when construing such policies, we look to determine the ordinary, everyday meaning of the words to the general public" and not to the parties' intent.[82] The Texas Supreme Court in *Boyer* found the parties' intent immaterial because the insurance commissioner prescribed the wording and language of the policies as the intent of the parties to the contract.[83]

> Therefore, a true search for what the courts usually speak of as the intent of the parties will not be an inquiry as to what the words of the contract meant to this particular insurer or insured.[84]

With the insurance business regulated and the policy forms prescribed by the Department of Insurance, the actual intent involved and the precise wording is as much or more the intent of the Department of Insurance which prescribes the wording of the policies as it is the intent of the parties.[85] Therefore, under current Texas Supreme Court precedent, the intent of the parties may not be material when construing insurance policy on a form which has been mandated by the Department of Insurance. However, in these cases, there may be other extrinsic evidence which may be useful in determining whether both interpretations are reasonable. This would include the drafting history, regulatory history, and the relevant actions of the Department of Insurance.[86]

D. Issue To Be Determined

With all the extrinsic evidence available, it is sometimes easy to get lost and lose focus on the issue to be determined from all the extrinsic evidence. The Texas Supreme Court has clearly held that the purpose of the extrinsic evidence is to ascertain the parties' intent.[87]

E. Resolution of Step #4

If after extrinsic evidence has been applied there is only one interpretation which is still

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[79] *Id.*

[80] *Id.* at 550.

[81] 153 Tex. 415, 269 S.W.2d 340, 341 (Tex. 1954).

[82] *Sink*, 107 S.W.3d at 551.

[83] *Boyer*, 269 S.W.2d at 341.

[84] *Id.*

[85] *Union Pacific Resources Co. v. Aetna Cas. & Sur. Co.*, 894 S.W.2d 401, 405 (Tex.App.–Fort Worth 1994, writ denied); *see United States Ins. Co. v. Boyer*, 153 Tex. 415, 269 S.W.2d 340, 341 (1954); *Dairyland County Mutual Ins. Co. v. Wallgren*, 477 S.W.2d 341, 342 (Tex.Civ.App.–Fort Worth 1972, writ ref'd n.r.e.).

[86] *Union Pacific*, 894 S.W.2d at 405.

[87] *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. C.B.I. Industries, Inc.*, 907 S.W.2d 517, 520 (Tex. 1995).

reasonable, the inquiry ends. The court is charged with construing insurance policy to conform it to the intent of the parties. This concept goes as far back as 1894 in *East Texas Fire Ins. Co. v. Kempner*.[88] If, however, the use of extrinsic evidence results in two reasonable interpretations, the one must go on to the fifth and final step of the algorithm.

VII. STEP #5 - CONTRA PROFERENTEM

A. Meaning of Rule

The rule of *contra proferentem* is that any ambiguous provision should be construed against the person who drafted the document.

The reason for construing insurance contracts against insurers is based upon a public policy argument that insurance policies are adhesion contracts and the unsophisticated, innocent insured needs protection. Under this argument, courts are more likely to adopt the construction of the policy in the light most favorable to the insured.[89]

According to historical cases in Texas jurisprudence, when the language of an insurance policy, "being the language of the underwriters," if it is susceptible to more than one interpretation, the construction that must be adopted is the one "which will sustain the claim of the assured, and give him the indemnity it was his object to secure."[90] Because the writers of the insurance policy could have made the meaning more clear, but they chose to place it where it is obscure and unclear in its meaning and construction, courts must resolve any doubt in favor of the insured.[91] "The rule for construing a policy of insurance is that the language used in it 'must be liberally construed in favor of the assured so as not to defeat, without a plain necessity, his claim or indemnity, which, in making the insurance, it was his object to secure. When the words are, without violence, susceptible of two interpretations, that which will sustain his claim and cover the loss must in preference be adopted.'"[92] Additionally, Texas law holds that "where the language is plain and unambiguous, courts must enforce the contract as made by the parties, and cannot

[88] 87 Tex. 229, 27 S.W. 122, 123 (1894) (The court found the language in the policy indicated that "the intention was to exclude judicial construction by making the terms unambiguous, and the court must enforce the contract as made.").

[89] See, e.g., *Eagle Leasing Corp. v. Hartford Fire Insurance Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976) (holding that "if the meaning of a policy provision is doubtful and the language used is susceptible of different constructions, the one most favorable to the insured is adopted").

[90] *Goddard v. East Texas Fire Insurance Co.*, 67 Tex. 69, 71, 1 S.W. 906, 907 (1886) (*citing Western Insurance Co. v. Cropper*, 32 Pa. St. 351). ("[W]hen an instrument of this character is inconsistent or ambiguous in its provisions, it must be construed most favorably for the assured."); *Goddard*, 67 Tex. at 75 (quoting Wood, Ins. § 59, and notes; *Hoffman v. AEtna Ins. Co.*, 32 N. Y. 405; *AEtna Ins. Co. v. Jackson*, 16 B. Mon. 242; May, Ins. 183, 184).

[91] Goddard, 67 Tex. at 75.

[92] *East Texas Fire Insurance Co. v. Kempner*, 87 Tex. 229, 237, 27 S.W. 122, 122 (1894) (citing 1 May, Ins. § 176).

make a new contract for them, nor change that which they have made under the guise of construction. As parties bind themselves, so they must be held to be bound."[93]

"It is elementary that insurance contracts, the language of which usually represents words and phraseology chosen by the company, where there is reasonable doubt or ambiguity should be construed most strongly against the insurance company, and in favor of the insured."[94] In cases where the insurer selects the language of the policy and the language is ambiguous or uncertain, the rules of construction require courts to adopt the construction most favorable to the insured when the meaning is susceptible to more than one reasonable interpretation.[95]

If a contract or insurance policy is found to be ambiguous, "we must resolve the uncertainty by adopting the construction that most favors the insured."[96] Courts are to adopt the construction of an exclusion "urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent."[97] Particularly, exceptions or limitations to liability must be strictly construed against the insurer and in favor of the insured.[98] However, this case demonstrates how the Texas Supreme Court failed to apply the rules of construction for contracts before applying the rule of contra proferentem. Only after examining the insurance policy in light of the circumstances in existence when the contract was entered and determining that more than one reasonable interpretation exists relating to a provision or term should courts should adopt the interpretation favoring coverage for the insured.[99] Therefore, this archaic rule has no place in Texas jurisprudence today because insurers no longer draft insurance policies and therefore insureds are not in a powerless position when negotiating with insurers for coverage.

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[93] *Id.*.

[94] *Dixie Fire Insurance Co. v. Henson*, 285 S.W. 265, 267 (Tex. 1926).

[95] *Davis v. National Casualty Co.*, 175 S.W.2d 957, 960 (Tex. 1943).

[96] *National Union Fire Insurance Co. v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex. 1991) (citations omitted).

[97] *Id.*.

[98] *Id.*.

[99] *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997).

B. Rule of Last Resort

The rule of *contra proferentem* under the Texas law should be applied as a rule of last resort. It should only be applied after application of the rules of construction and after use of extrinsic evidence, there remains two reasonable interpretations. If application of these rules, only one interpretation is reasonable, the rule does not apply. The rule of application was detailed by the supreme court in *Universal CIT Credit Corp. v. Daniel*.[100] There, the supreme court held that:

> In other words, if after applying established rules of interpretation to the contract, it remains reasonably susceptible to more than one meaning, it is ambiguous, but if only one reasonable meaning clearly emerges, it is not ambiguous. In the latter event, the contract will be enforced as written and parol evidence will not be received for the purpose of creating an ambiguity or give the contract a meaning different from that which its language imports. [Citations omitted.] Neither in this latter event may the rule of strong construction against the author be invoked. That rule is applied only where a contract is open to two reasonable constructions. [Citations omitted.] The rule that expressions will be interpreted against the persons using them applies only where, after the ordinary rules of interpretation have been applied, the agreement is still ambiguous.[101]

This rule is also consistent with the resolution of ambiguities in ordinary contracts. Commentator Corbin has stated, in his treatise on contracts:

> It is frequently said that this rule [*contra proferentem*] is to be applied only as a last resort. It should not be applied until other rules of interpretation have been exhausted. Nor should it be applied unless there remain two possible and reasonable interpretations.[102]

The proposition that the rule of *contra proferentem* should only be applied as a rule of last resort is also been applied in the interpretation of insurance contracts.[103]

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[100] 243 S.W.2d 154 (1951).

[101] *Id.* at 157.

[102] 3 A. Corbin, Corbin on Contracts, section 559, 1960.

[103] 907 S.W.2d 430, 433 (Tex. 1995) ("Only if an insurance policy remains ambiguous despite these canons of interpretation should courts construe its language against the insurer in a manner that favors coverage."); *Mang v. Travelers Ins. Co.*, 412 S.W.2d 672, 674 (Tex.Civ.App.–San Antonio 1967, writ ref'd n.r.e.) ("[U]nder this maxim of strict construction, the judicial thumb will be placed on the scales in order to make them tip in favor of the insured only when use of the other so-called aids to construction leave the scales so nearly in equilibrium that the policy may reasonably be given one of several constructions.").

C. Exclusions

It has been a well settled rule in this state that policies of insurance will be interpreted and construed liberally in favor of the insured and strictly against the insurer, and especially so when dealing with exceptions and words of limitation.[104]

Further, the Texas courts adopt the construction of an exclusionary clause urged by the insured as long as that construction is not itself unreasonable even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent.[105]

On the other hand, the courts recognize that these rules of construction will be applied only when the language of the policy is such that it may reasonably be given on of several constructions. In other words, the plain language of an insurance policy, like that of any other contract, will be given effect when the parties' intent may be discerned from that language. Language used in exclusion must be taken in its ordinary and usual sense, and must be given such interpretation as was probably in contemplation of parties when policy was issued.[106] Exclusions must be explicit to ensure that a policyholder's reasonable expectation of coverage is not thwarted.[107]

Applying these general rules to exclusions, it can be said that any exclusion or limitation that is subject to reasonable, conflicting interpretation will be considered ambiguous, in such a case the court must resolve the uncertainty by adopting the construction that most favors the insured. This

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[104] *Canutillo Indep. Sch. Dist. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.,* 99 F.3d 695, 701 (5th Cir. 1996); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Hudson Energy Co., Inc.*, 811 S.W.2d 552 (Tex. 1991); *Ranger Ins. Co. v. Bowie*, 574 S.W.2d 540 (Tex. 1978); *Glover v. National Ins. Underwriters*, 545 S.W.2d 755 (Tex. 1977); *Ramsay v. Maryland American General Ins. Co.*, 533 S.W.2d 344 (Tex. 1976); *Gulf Ins. Co. v. Parker Products, Inc.*, 498 S.W.2d 676 (Tex. 1973); *Continental Cas. Co. v. Warren*, 254 S.W.2d 762 (Tex. 1953); *Providence Washington Ins. Co. v. Profitt et al.*, 239 S.W.2d 379 (Tex. 1951); *Brown v. Palatine*, 35 S.W. 1060,1061 (1896); *American Fidelity & Casualty Co., Inc. v. Williams*, 34 S.W.2d 396, 402 (Tex. App.--Amarillo 1930, writ dism.); *Norwood v. Washington Fidelity Nat. Ins. Co.*, 16 S.W.2d 842 (Tex. App.--Beaumont 1929, no writ history).

[105] *Utica Nat. Ins. Co of Texas v. American Indem. Co.*,141 S.W.3d 198 (Tex 2004); *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Hudson Energy Co.*, Inc., 811 S.W.2d 552 (Tex. 1991); *Barnett v. Aetna Life Ins. Co.*, 723 SW2d 663 (Tex. 1987); *Glover*, 545 S.W.2d at 761; *Insurance Co. of North America v. Cash*, 475 S.W.2d 912 (Tex. 1972); *Continental Cas. Co. v. Warren*, 254 S.W.2d 762 (Tex. 1953).

[106] *Howard v. Missouri State Life Ins. Co.*, 289 SW 114 (Tex. 1926); *Potomac Ins. Co. v. Easley*, 1 SW2d 263 (Tex.1928); *Vaughn v. Atlantic Ins. Co.*, 397 SW2d 874 (Tex.App.--Tyler 1965, writ ref n.r.e.); *National Life & Acci. Ins. Co. v. Martin*, 554 S.W.2d 553 (Tex. App.--Tyler 1977, writ ref'sd n.r.e.); *DiFrancesco v. Houston Gen Ins. Co.*, 858 SW2d 595 (Tex. 1993).

[107] *See Kulubis v. Texas Farm Bureau Underwriters Ins. Co.*, 706 S.W.2d 953, 955 (Tex.1986); *Kelly Assocs., Ltd. v. Aetna Casualty & Sur. Co.*, 681 S.W.2d 593, 596 (Tex.1984); *Ramsay v. Maryland Am. Gen. Ins. Co.*, 533 S.W.2d 344, 347 (Tex.1976).

rule of "contra proferentem" evolved back in the 1800's when underwriters prepared the insurance contracts to suit themselves. They were able to choose language to guard against fraud, negligence, want of interest, etc., but they had to do so in a manner not calculated to mislead the parties with whom they deal. They had it in their power to express their meaning in a way not to be misunderstood, or to be capable of any other construction except that which they must know the assured will give to the language. If the contract was capable of an interpretation, the underwriters must expect that it will be construed against them since they were the drafters.[108]

D. Mandated Policies

There is some question regarding whether the rule of *contra proferentem* should apply in those policies where the language is mandated by the state rather than the insured or the insurer. In these occasions, it makes little sense to construe the policy language against the insurer when the insurer is not the drafter. The Texas courts should not automatically accept the general rule that exceptions and limitations in an insurance policy be strictly construed against the insurer. The policy behind applying contra proferentem to interpreting exclusions no longer applies as the insurance business is now being regulated and policy forms are proscribed by the state insurance Department. It is the Insurance Department which prescribes the wording of the policies, not the underwriters of an insurance company.[109] The actual intent involved in the precise words of the policy is much more the intent of the Department of Insurance that prescribes the policy wording then the intent of the parties.[110] Since the insurer is not the person who selected the language of the policy, strictly construing exceptions and limitations against the insurance companies defeats the reasoning for enforcing such a rule. The Texas courts should return to the original rules of construction applicable to other contracts in interpreting an exclusion or limitation in an insurance policy. Courts must give full effect to the written expression of the parties' intent. If the courts are unclear on the parties' intent, they only need to look the Insurance Department's drafting history, regulatory history, and relevant actions of the State Board of Insurance to determine the parties' intent.[111]

E. Sophisticated Insureds

An exception to the general rule of construction of ambiguities against the insurer may apply when the insured is a sophisticated,

[108] *Goddard v. East Texas Fire Ins. Co.*, 1 S.W. 106 (Tex. 1886).

[109] *Union Pacific Resources Co. v. Aetna Casualty and Surety Co.*, 894 S.W.2d 401, 405 (Tex. App.--Fort Worth 1994, writ denied); Dairyland County Mutual Ins. Co. v. Wallgren, 477 S.W.2d 341,342 (Tex. App.--Fort Worth 1972, writ ref'd n.r.e).

[110] *Home Ins. Co. v. Cox*, 269 S.W.2d 343, (Tex. 1954); *United States Ins. Co. v. Boyer*, 269 S.W.2d 340 (Tex. 1954).

[111] *Union Pacific Resources Co. v. Aetna Casualty and Surety Co.*, 894 S.W.2d 401 (Tex. App.--Fort Worth 1994, writ denied).

large corporation who is represented by brokers to secure tailor-made coverage, rather than the insurance company drafting the policy itself. The Fifth Circuit was not compelled to apply, nor justified in applying the rule of contra proferentem in a commercial setting where the insured is not an innocent, but rather is a large corporation with business sophistication.[112] The court pointed out that the rule is applied only when an insurance contract is a '"contract of adhesion'" and the insured has no bargaining power.[113] The Fifth Circuit held that the insurance policy language is attributable to both parties equally.[114] The court held that the insurance policy should be construed so as to give a reasonable meaning that reflects the parties' intentions most closely.[115] This exception is sometimes known as the Sophisticated Insured Rule. Some legal commentators continue to disagree with the application of this rule. For example, Long states that:

> While it is certainly true that "sophisticated insureds" are in a much better negotiating position than our average consumers, it does not necessarily follow they are on the same footing as insurers. This is because insurers still tend to have much greater expertise than even the most sophisticated insured, especially when sharing of information within the industry is considered. In any event, the treatment of "sophisticated insureds" is an area that is very much in the early stages of development, and one that warrants future consideration.[116]

On the other hand, Ostrager and Newman state that "there is a substantial body of case law holding that contra-insurer rules of construction should not apply to business insurance."[117] Ostrager and Newman argue that since business insurance policies are typically negotiated (and often drafted) on behalf of the insured by sophisticated brokers, risk managers and/or counsel, it can be argued that a business insurance policy should not automatically be construed against the insurer. Id. Ostrager and Newman note that courts that have declined to apply the contra-insurer rule have relied upon evidence establishing the equivalence of bargaining power between the insurer and insured, including: 1) the large size of the business insured, 2) the involvement of counsel on behalf of the insured in the negotiation of the policy, 3) the representation of the insured by an independent broker in the negotiation of the policy, 4) the use of a "manuscript" policy, 5) the "insurance" sophistication of the insured, 6) whether the dispute is between two

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[112] *Eagle Leasing Corp. v. Hartford Fire Insurance Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976).

[113] *Id.* ("Only for this reason, is the policy construed against the insurer.").

[114] *Id.*

[115] *Id.*

[116] 3 Long, The Law of Liability Insurance, § 16.06 (1996).

[117] Ostrager and Newman, Handbook on Insurance Coverage Disputes, § 1.03 [c] (1995).

insurance companies; and 7) whether the parties possess equal bargaining power.[118]

VIII. CONCLUSION

In conclusion, the interpretation and construction of insurance policies in Texas, while frequently misunderstood and misapplied, does have specific aura and substance. The foregoing steps reflect the rules of interpretation and construction adopted by the supreme court as well as the order in which they should be applied.

[118] *Id.*