

THE RHA REVIEW

ROUTE TO:

Vol. 6, No. 1, Fourth Quarter 1999

A publication of Robert Hughes Associates, Inc., an international litigation support, actuarial, risk management and insurance consulting company.

SOPHISTICATED LADY

By Robert N. Hughes, CPCU, ARM

The images created by the liquid tones of Duke Ellington's elegant jazz tune, "Sophisticated Lady," were powerful ... even for a preteenage kid. I always had visions of some classy female bedecked in diamonds and a tight-fitting floor-length dress, smoke curling from a long, extended cigarette holder, seductively descending a winding staircase. That song and its accompanying image were my principal sources for an early understanding of the meaning of the word *sophisticated*. Today, however, in the realm of insurance litigation (where I spend much of my time), the word has taken on a new and, at least for the policyholder, ominous aspect. But I digress. Let's back up a bit and I'll try to begin this tale at the beginning rather than in the middle.

We begin our story with the proposition that insurance policies are contracts. (And, for the sake of simplicity, let's discuss only liability insurance policies.) I doubt that comes as a surprise. You probably also know that there are different sorts of contracts. There are those in which the



two parties essentially sit down together, negotiate until an agreement is reached and then reduce that agreement to a contract. By contrast, there are contracts that are written by one party expressing the obligations of that party, and the other party "takes it or leaves it." In the latter case, the acceptance of the terms by the non-drafting party is usually marked by the payment of some consideration, such as a premium.

Insurance policies, almost without exception, fall into the latter category. The insurance company or

its representatives write the policy and offer it to the insured. The insured simply pays the premium. Such contracts are called "contracts of adhesion."

Written contracts are composed of words and phrases, and we all know that words and phrases can be understood differently by different persons. For instance, if I tell my son to "please bring me the table from the library," he might bring me the small nested table on which I generally eat my supper while watching the Texas Rangers embarrass themselves. But he might bring me the timetable for airline arrivals and departures. My request was ambiguous. Insurance policies are also ambiguous. For instance, does the word *sudden* mean "quick and instantaneous," or does it mean "coming unexpectedly?" Do the words *body of water* mean only such things as rivers, lakes and oceans, or can they also mean microscopic molecules of water located deep in the ground, commonly known as groundwater? These and many other ambiguities are the subject of almost constant litigation in which various trial, appeals and supreme courts labor to discover the appropriate meanings of insurance policies.

(SOPHISTICATED, continued inside)

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(SOPHISTICATED, cont'd. from cover)

Courts resolve ambiguities in various ways, and we can talk about that another day. For now, however, let us consider what happens when the ambiguity cannot be resolved. In such cases, the nondrafting party to a contract is protected by a doctrine of law called *contra proferentum*. This is a Latin phrase meaning "against the proffering party." The principle of the doctrine is that ambiguities are always interpreted against the drafter of the ambiguous language.

As you can now imagine, the question of who wrote the policy is extremely important. Policyholders generally take the position that every policy was written by the insurer. Insurance companies and underwriters, however, often take the position that anything other than the professionally printed standard-form policy is a "manuscript" policy, written by someone other than themselves.

Without getting down to the specifics of all the arguments, I'm sure you get the point. The drafter of the policy is generally the loser in the resolution of ambiguities. Whether *sudden* means "quick" or "unexpected" depends on what best suits the policyholder.

"If insurers can convince a court that their policyholder is a 'sophisticated' buyer, they might not have to suffer the consequences of having sold ambiguous contracts."

But wait. There are some saving factors from the drafter's standpoint. The law in many states provides that a nondrafter who is a "sophisticated" buyer is deemed to be on equal footing with the drafter, and *contra proferentum* does not apply. (You thought we'd never get there, didn't you?) The term *sophisticated* is

itself ambiguous, but the meaning that apparently applies in this case is "finely experienced and aware." So if insurers can convince a court that their policyholder is a "sophisticated" buyer, they might not have to suffer the consequences of having sold ambiguous contracts.

That brings us to the point of all this (finally, you say). The point is that many risk managers and brokers insist on telling the world that they have written their own policies. Further, they go on ad nauseam about their great knowledge and high degree of sophistication. Although such statements might seem benign, many have actually seriously damaged their companies' ability to claim coverage on their liability insurance policies. What's more, the problem continues and will have the same result in the future.

Take, for instance, the Fortune

(SOPHISTICATED, continued opposite)

FROM NEAR AND FAR



In September a very strong earthquake rocked Taiwan, causing an estimated \$2 billion in insured losses. More than 2,000 lives were lost during the quake, which measured 7.6 on the Richter scale, and as a result of the subsequent aftershocks.



At the end of October a Boeing 767-300 crashed shortly after takeoff from New York's Kennedy International Airport. EgyptAir Flight 990 disappeared from radar screens less than an hour after taking off bound for Cairo, Egypt. All 217 passengers and crew died. Insured loss amounts are unknown at press time.



According to the Property Claim Services unit of the Insurance Services Office in New York, claims resulting from natural disasters during the third quarter of 1999 will amount to more than \$2.1 billion. There were seven events that led to more than 800,000 claims. Hurricane Floyd alone was responsible for more than half of the losses.

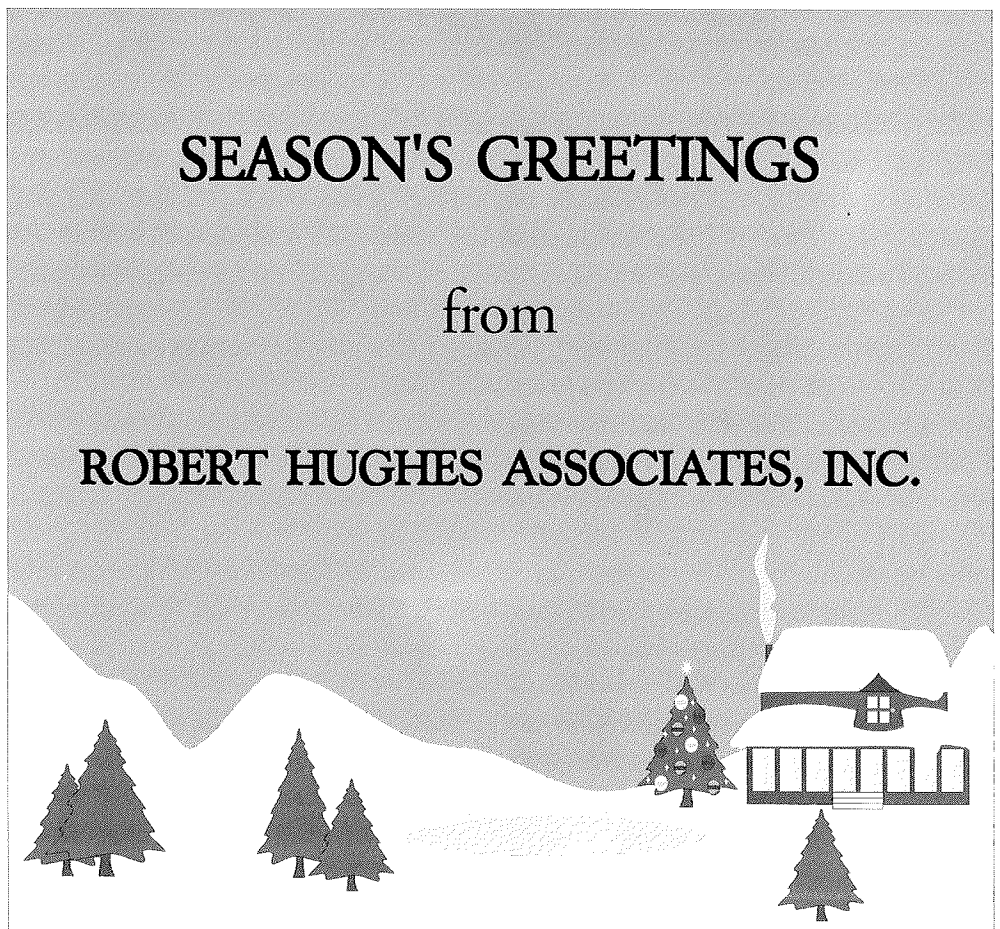
(SOPHISTICATED, from opposite page)

100 company whose "manuscript" liability policies are nothing more than sections of standard policies that have been clipped and reassembled in a different order. The revised assemblage does make for a somewhat more readable policy, and this would have been fine had it ended there. Unfortunately, the risk manager had a habit of crowing to his superiors that he himself had created a manuscript policy "uniquely tailored to the needs of _____" and "virtually unavailable in the general insurance market." As

"Even when authorship is clear, claims of super-sophistication may eliminate or damage the saving graces of *contra proferentum*."

you can imagine, those posturings were used by insurers to invoke the "authorship" and "sophisticated insured" defenses.

Sadly, this egoist's name is legion. Litigation records are filled with the utterances of risk managers and brokers bragging to their bosses or their clients about their own "sophistication" and expertise. These same people often also claim that their programs are rare and unique. Never mind the fact that the policies contain insurance industry standard wordings that have been deemed by many courts to be ambiguous. Unfortunately, these claims of authorship by policyholder employees or brokers often make the invocation of the doctrine of *contra proferentum* difficult at best. Furthermore, even when insurer



authorship is clear, claims of super-sophistication may eliminate or damage the saving graces of *contra proferentum*.

So you know from whence I come. You've heard it. The hot-shot risk manager of the Fortune 100 company who makes speeches hyping the uniqueness of his company's insurance program. The broker who describes a "cut and paste" form in her correspondence as "our wording." The president of the captive insurer who describes his company's rather typical program as "entirely unique." Frankly, all these people would serve their company's interests far better by just keeping their mouths shut. The fact is that in my almost 40 years in and around the insurance business I have seen fewer than five liability policies that I would consider to be truly

unique and worthy of the designation "manuscript," and not a single one of those was drafted by the policyholder.

No one would argue that the Duke and his music were unsophisticated. And those of you who are lucky can sit back with a glass of cold Chardonnay, put on an Ellington CD and let the insurer and policyholder lawyers "duke" it out. For others, unfortunately, the contracts are ambiguous, it is unclear who wrote them and the word *sophisticated* rings through the halls of justice. There are millions of dollars at stake. The problem is sophisticated, all right ... serious, too. **RHA**

Robert N. Hughes is founder and president of Robert Hughes Associates, Inc.

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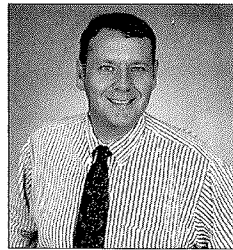
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TWO NEW POSITIONS

Our editor, John Oakley, has been named executive vice president of Robert Hughes Associates, Inc. John was formerly vice president of Oakley Marketing Associates, Inc., a marketing company that was responsible for a significant amount of RHA's marketing, advertising and public relations.



John R. Oakley
Executive Vice President

His primary responsibilities will be to assist with the daily running of the organization, the continued development of the litigation support practice, and coordination between clients and consultants. He will retain his duties related to advertising, marketing and public relations.

Our assistant editor also has a new title. Alice Oakley has been named senior vice president. Alice was previously, and still is, the director of marketing and the office manager. She will retain her responsibilities for the day-to-day operation of the Dallas office and will continue to oversee the company's marketing efforts. Alice will also be taking an active role in the daily running of the organization. She joined RHA in January 1994 following four years with Southern Methodist University and two years with London broker J. Besso & Co. 



Alice H. Oakley
Senior Vice President

THE RHA REVIEW

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The RHA Review is published quarterly by Robert Hughes Associates, Inc. — an independent international litigation support, actuarial, risk management and insurance consulting company based in Dallas, Texas, with offices in Houston, Texas, and London, England. The purpose of this publication is to offer insurance-related information and critical comment pertinent to the clients, friends and fellow professionals of Robert Hughes Associates, Inc. This publication is available free to interested parties. The information contained in this publication is intended to be general in nature; readers should obtain professional counsel before taking any action on the basis of this material.

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