When reading the insurance policy is not enough

Why some insurance policy limitations and exclusions may not be enforceable

By David Lilienstein and Jessica Cho

"You'd have to be a Philadelphia lawyer to understand that policy," an older gentleman from Michigan once remarked to me. He had called to complain about an accidental disability policy he owned. Turns out that buried deep in his policy was language excluding every kind of disability but dismemberment, paralysis, or blindness. Much to his surprise, his disability policy was actually a dismemberment policy. OK, a dismemberment, paralysis or blindness policy.

This wasn't just a "bait and switch" tactic. It was worse: the insurer's choice of language was designed to mislead insureds into believing they had coverage they did not have.

We informed Mr. Michigan that generally speaking, policyholders are charged with reading and understanding their policy, whether they have a PhD or a GED. Questions? Call the company for clarification, because, we explained, if a policy limitation or exclusion is in the contract, it is enforceable.

At least that's largely the case in Michigan, and in many jurisdictions around the country. Fortunately, California law is much more forgiving for policyholders in this area, and is much more realistic about the realities of insurers and how they draft their policies. Here, courts recognize that there can be a big difference between reading a policy and understanding its terms and conditions. Courts further recognize that insurers do not go out of their way to use policy language that is understandable to the average person of average intelligence. As a result, California courts will not enforce policy limitations and exclusions that are not brought to the attention of insureds. This article provides some insights into when insurance limitations and exclusions regarding coverage should and should not be enforceable.

Duty to read the policy

The general rule for insurance policies is that a party is bound by contract provisions that are conspicuous, plain, and clear. (*Fields v. Blue Shield of California* (4th Dist. 1985) 163 Cal.App.3d 570, 578-79.) Consequently, the insured who testifies he or she did not read their policy is unlikely to prevail. But what does it really mean to "read" a policy. Many consumers – not to mention attorneys – have a limited knowledge of insurance terms, and insurers don't always provide the necessary definitions. Accordingly, it is commonly accepted that very few policyholders fully understand the provisions of their policies, how those provisions work in concert with each other, and the consequences of those interactions. (*Haynes v. Farmers Insurance Exchange* (2004) 32 Cal.4th 1198.

And then there are health insurance policies, for which the summary alone can be upwards of 100 pages. The difficulties in understanding such insurance policies have been documented in several studies that explored consumers' reactions to health-plan information. (G. Loewenstein, et al. *Consumers' misunderstanding of health insurance*, 32 Journal of Health Economics 850-862 (2013).) These studies confirmed that consumers are generally confused by many key insurance terms and are unable to combine and understand a variety of cost sharing concepts. Even when consumers report that they understood a term (such as co-insurance), exercises with simple hypotheticals revealed that consumers did not actually understand how to use the concept. As a result, people often believe their health carrier's denial is legitimate simply because they don't fully understand the coverage at issue.

Conspicuous, plain, and clear, or else

One of the worst things an insurer can do, outside of an outright claim denial, is to lower the policy limits without properly notifying its insured. This happened in an automobile insurance policy in a case that went all the way up to the California Supreme Court. *Haynes v. Farmers Ins. Exchange* (2004) involved the enforceability of an automobile policy with substantially lower policy limits for a permissive driver than for the policyholder. (*Haynes, supra*.) The declarations page of the policy set forth the greater policy limits, while the permissive driver limitation was not introduced until the tenth page of the policy, in the subsection titled "Other Insurance." An actual explanation of the limitation for permissive user coverage did not appear until the 24th page of the policy, in the middle of the paragraph, in three lines of ordinary font that was not "bolded, italicized, enlarged, underlined, in different font, capitalized, boxed, set apart, or in any other way distinguished from the rest of the fine print." (*Id.* at 1204 (quoting *Thompson v. Occidental Life Ins. Co.* (1973) 9 Cal.3d 904, 921.)

In language that every practitioner of insurance law should be familiar with, the California Supreme Court, in no uncertain terms, set forth the "conspicuous, plain and clear" standard:

> In the insurance context, we begin with the fundamental principle that an insurer cannot escape its basic duty to insure by means of an exclusionary clause that is unclear. As we have declared time and again any exception to the performance of the basic underlying obligation must be so stated as clearly to apprise the insured of its effect. . . [T]o be enforceable, any provision that takes away or limits coverage reasonably expected by an insured must be conspicuous, plan and clear. Thus, any such limitation must be placed and printed so that it will attract the reader's attention.

(*Id*. (internal citations omitted))

The court found the Farmers limitation provision was not conspicuous, plain and clear, and was, therefore unenforceable. Notably, it did not dictate precisely how an insurer should bring important policy limitations to its insured. The Court left no doubt, however, that "the burden of making coverage exceptions and limitations conspicuous, plain and clear rests with the insurer." (*Id*. (citing *State Farm Mut. Auto. Ins. Co. v. Jacober* (1973) 10 Cal.3d 193, 202.) Thus, an insurer must do something more than burying relevant policy language in the nether regions of the policy, knowing full well that the language is unlikely to be understood by its insureds.)

No sneaky policy drafting

Insurers still cling to the defense that simply putting policy language anywhere in a policy is sufficient. They will confirm that their insured received the policy, and "read" it. However, directing the insured to read the policy is not a substitute for notice of a loss of benefit. (*Fields v. Blue Shield* (1985) 163 Cal.App.3d 570, 583.) Insureds are bound to be misled when insurers prominently and boldly express certain policy coverage, while placing important exclusions of coverage in inconspicuous places. If the language and form of a policy is confusing, then an insured's duty to read can no longer be a shield for insurance companies.

California courts follow the rule that the duty to read is insufficient to bind a party to unusual or unfair language unless it is brought to the attention of the insured and properly explained. (*Id*. at 578 (quoting *Weaver v. American Oil Company* (1971) 276 Ind. 458.)

Exclusionary clauses must be precise in their language and conspicuous, plain and clear. (*Ponder v. Blue Cross* (1983) 145 Cal.App.3d 709, 719.) This rule applies with particular force when a policy's coverage portion leads an insured to reasonably expect coverage for the claim that was excluded.

In determining whether a limitation or exclusion is conspicuous, courts consider whether the provision is written, displayed or presented in a way that a reasonable person would notice it. (*Esparza v. Burlington* (E.D. Cal. 2011) 866 F. Supp. 2d 1185, 1201.)

Conspicuous terms include capitalizing a heading; placing language in the body of a record or display in larger type than the surrounding text; contrasting type, font, or color to the surrounding text of the same size; or setting off text from the surrounding text of the same size by symbols or other marks that call attention to the language. (*Broberg v. Guardian Life Ins. Co. of America*, (2009) 171 Cal.App.4th 912,922-23.)

Even if a provision is plainly worded, it may still be deemed inconspicuous if it is hidden away in unusual parts of the policy. In *Fields v. Blue Shield of California*, the court struck down a provision limiting coverage that was inconspicuously placed at the end of provisions granting benefits, instead of the limitations or exclusions section.

At the other end of the spectrum, confusing policy language has still been found enforceable. In cases where courts have held policies valid, a reasonable layperson could still find the policy provision confusing, ambiguous, and daunting.

But wait...

When drafted properly, limitations and exclusions will be enforceable. In *Dominguez v. Financial Indemnity Co.* (1910) 183 Cal.App.4th 388, the court upheld a reduction in coverage for permissive users that was placed early in the policy and referenced multiple times in appropriate subsections within the policy, holding that the language was conspicuous, plain and clear. While policies habitually direct insureds to go over exclusions, each reference in *Dominquez* directed the insured to specific pages that explain the coverage reduction. The dissent argued the policy never defined the term "permissive users" and the pages that mentioned the permissive user limitation never cross-referenced each other, therefore under *Haynes* the policy was ambiguous.

Elsewhere, a limiting provision in an automobile policy was held enforceable in *Ortega v. Topa Ins. Co*. (2012) 206 Cal.App.4th 463, 475. The provision was boxed off with separate signature lines certifying the insured's understanding and contained four paragraphs with additional spacing between each paragraph.

The limiting provision at issue was encased within the second paragraph. Despite the fact that the limiting provision lacked larger typeface, bold font, and detailed headings, the court relied on the positioning and formatting of the provision to conclude that it was sufficiently conspicuous to be enforceable.

The Flesch readability score

What is "plain and clear" language? Is there a test? Does one have to find James Joyce's *Ulysses* a model of readability in order to understand insurance policies?

Enter the Flesch-Kincaid readability test. The "Flesch test" evaluates blocks of texts on a 100-point scale, with 100 representing the easiest readability. (https://readability-score.com) Scores of over 90 points are easily understandable by the

average fifth grader, while scores of 0-30 points are best understood by college graduates.

The Flesch Test also provides an accompanying grade level. For example, take the following language, present in most California settlement agreements.

This settlement includes an express waiver of Civil Code section 1542, which states:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.

Put this language into the Flesch test (this can be done very easily online), and the result is a 52.5 score, and a grade level of 13.5.

During the 1980's, states began to regulate the readability of insurance policies. Some states now mandate Flesch reading scores ranging from 40 points to 50 points, or a tenth grade reading level. Other states have more general readability standards, with the general rule that a policy should be readable for a person with an eighth or ninth grade reading level.

While the intent behind requiring minimum Flesch scores is well-meaning, insurance companies have figured out ways to work around this metric. It is not enough to require insurers to draft language in a policy with simpler sentence structure and basic terms. Currently, insurance companies have taken to rendering the format of the policy itself difficult. Language that barely meets the minimum Flesch score requirements is now carefully hidden within unrelated sections and buried in a maze of densely packed paragraphs. Even if a policy passes a state's minimum Flesch score requirement, an insured could still be utterly lost in how to read and interpret his or her policy.

California Readability Standards (Cal. Ins. Code, § 10270.95)

Currently, California reserves discretion to the California Department of Insurance ("DOI"), via its policy approval process, to ensure fairness in insurance policy language. For example, the readability standards for disability insurance policies are codified in California Insurance Code § 10270.95, which reads as follows:

> The purpose of this section is to achieve both of the following:
> •Prevent, in respect to disability insurance, fraud, unfair trade practices, and insurance economically unsound to the insured.
> •Assure that the language of all insurance policies can be readily understood and interpreted.
> The commissioner shall not approve any disability policy for insurance or delivery in this state in any of the following circumstances:
> •If the commissioner finds that it contains any provision, or has any label, description of its contents, title, heading, backing, or other indication of its provisions which is unintelligible, uncertain, ambiguous, or abstruse, or likely to mislead a person to whom the policy is offered, delivered or issued.

Under Section 10270.95(b)(1), the legislature sought to protect insureds from unexpected and unreasonable denials of coverage. Insurers must draft policy terms that are intelligible, certain, and unambiguous. The language of all insurance policies must be readily understood and interpreted to a reasonable layperson. Unusual arrangements of common words and exclusionary clauses that derive its entire meaning from uncommon words have been deemed incomprehensible and unenforceable. (*Ponder v. Blue Cross of Southern California, supra,* 145 Cal.App.3d at 725.)

The commissioner approved my policy, Or did he?

Insurers routinely cite to the DOI approval of a policy form as evidence that the policy is intelligible, clear, and unambiguous. Do not accept this simplistic argument. The DOI is not a court of law, and it operates under different standards of policy interpretation. More importantly, the Insurance Commissioner can do nothing, and after 30 days a policy form can be deemed approved. (Cal. Ins. Code, § 10270(b)(1).) Conveniently, insurers fail to disclose this backdoor stamp of approval, and still contend that the policy language is beyond reproach.

Recently, in a big win for policyholders, this approval argument was rebuffed by a California appeals court. In *Ellena v. Dept. of Ins.* (2014), 230 Cal.App.4th 388, the plaintiff contended that a disability policy contained a definition of disability that conflicted with California law, and sought a writ of mandate ordering the insurance commissioner duty to review insurance policies under section 10270.95(b)(1). (230 Cal.App.4th 198 (1st Dist. 2014). The Commissioner contended that this was unnecessary because of the 30-day non-approval approval process.

The Court of Appeals held that this process was unacceptable and granted the writ of mandate. It also discussed the need for review of insurance policies for readability before approving them for sale to the general public. Letting 30 days expire without a review is not an acceptable review process, it held. This is due to the long-accepted fact that many, if not most, consumers do not readily understand the meaning of insurance policies, even after reading them.

After *Ellena*, practitioners should be sure to find out whether the carrier submitted a policy form to the DOI, whether the form was approved, and specifically how it was approved. The California Supreme Court denied the Dept. of Insurance's petition for review in *Ellena* on December 17, 2014.

Special rules of interpretation

Special rules of construction and interpretation apply when it comes to enforcement of exclusions and limitations in insurance policies. (*Id.* at 718-20.) The core doctrines of insurance law revolve around reasonable expectations and

contra proferentem (ambiguities in contract are decided in favor of coverage). These doctrines support a body of case law that directs insurance companies to draft policies that are comprehensible to a lay person. "Precision is not enough. Understandability is also required." (*Id.* at 723.)

Due to the unequal bargaining strength of the parties, insurance contracts are characterized as adhesion contracts. This creates a higher burden on the part of insurers to make their policies readable to a reasonable layperson. If the language of the policy is clear and unambiguous, then the court will apply the plain meaning of the unambiguous provisions of the policy. However, if a provision is ambiguous, then the court proceeds to step two and determines the reasonable expectations of an insured.

Conclusion

In California, unlike in many other jurisdictions, the playing field regarding insurance policy language is now largely even. Insureds must read their policies. Insurers must make the "conditions, exceptions and provisions of a policy clear to the ordinary mind engaging in a plain, commonsense reading of the terms." (*Clarendon Not. Ins. v. Insurance Co. of the West* (E.D. Cal. 2006) 422 F. Supp. 2d 914, 933.) Perhaps most importantly it is the insurer's obligation and burden to make its policy exclusions and limitations conspicuous, plain and clear. (*Id.* at 718-20.)

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