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Do Actions Speak Louder than Words?

How the Parties' Prior Course of Performance Impacts Insurance Policy Interpretation

By Caroline Marks and Keven Drummond Elber

"I have noticed that nothing I never said ever did me any harm." Calvin Coolidge

Insurance coverage litigation frequently requires coverage lawyers to take on the role of archeologist and historian. Particularly in cases involving long-tail claims, multiple triggered policy periods and the resurrection and scrutiny of decades-old policies, we look for evidence tending to show that the opposing party has interpreted certain policy provisions differently from the interpretation it now advances for the very same provisions. Extrinsic evidence of past policy interpretation may take many forms, and one form is evidence of the parties' own course of performance with regard to the insurance policies at issue.

In essence, where an insurance policy is ambiguous, a court may consider the parties' course of performance of their contract as extrinsic evidence of the construction they gave to it. To be probative, however, the course of performance must be conclusive and mutual. Then, such course-of-performance evidence is generally entitled to considerable weight in ascertaining the parties' intent, unless a party provides an alternative explanation for its conduct that negates the probative value of such evidence.

Extrinsic Evidence and Ambiguity

Insurance policies are contracts, and in most jurisdictions, general rules of contract interpretation apply. This typically means that extrinsic evidence regarding the parties' course of performance is irrelevant when the contract provision in question is unambiguous. *See Gulf Ins. Co. v. Transatlantic Reins. Co.*, 69 A.D.3d 71, 81, 886 N.Y.S.2d 133, 140 (1st Dep't 2009) ("[T]he extrinsic proof that Gulf relies on, however powerful it may be, is irrelevant for it cannot be admitted to vary the unambiguous language of each I&L contract and its accompanying treaty (citation omitted)."); *Manor Care, Inc. v. First Specialty Ins. Corp.*, No. 3:03CV7186, 2006 U.S. Dist. LEXIS 48249 (N.D. Ohio July 17, 2006) (declining to consider course of performance evidence to determine how many SIRs should apply to a single lawsuit where insurance policy was unambiguous); *Emcor Group v. Great Am. Ins. Co.*, No. ELH-12-0142, 2013 U.S. Dist. LEXIS 43346, *35-6, 2013 WL 1315029 (D. Md. Mar. 27, 2013) ("Because the 2004 policy is not ambiguous, I decline to consider Emcor's extrinsic evidence.").

This holds true, even in situations where the parties mistakenly performed in a manner inconsistent with unambiguous contract terms over a prolonged period of time. *See, e.g., In re Chicago & E.I.R. Co.*, 94 F.2d 296 (7th Cir.1938) ("But when the contract is clear, the fact that the parties followed a different plan cannot work a revocation of the plain agreement. 'Where there is doubt as to the proper construction of an instrument,' the conduct of the parties 'is entitled to great consideration. But where its meaning is clear in the eyes of the law, the error of the parties cannot control its effect.'"), quoting *R.R. Co. v. Trimble*, 10 Wall. 367, 377, 19 L.Ed. 948; *Shroeder v. Terra Energy*, 223 Mich. App. 176, 192-93, 565 N.W.2d 887 (1997).

Where an insurance policy is ambiguous, however, a court may consider extrinsic evidence to ascertain the parties' intent. *Empl'rs Reinsur. Corp. v. Mass. Mut. Life Ins. Co.*, No. 06-0188-CV-W-FJG, 2008 U.S. Dist. LEXIS 63420, *23-24, 2008 WL 3890358 (W.D. Mo. Aug. 19, 2008). The parties' course of performance of their contract constitutes extrinsic evidence of the practical construction which they gave to their agreement. *See generally* 5 Corbin on Contracts, Section 24.16; Restatement (Second) of Contracts § 202(4) (1981) ("Where an agreement involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is given great weight in the interpretation of that agreement."); *Cincinnati Ins. Co. v. ACE INA Holdings, Inc.*, 175 Ohio App.3d 266, 2007-Ohio-5576, ¶33 (1st Dist.); As explained by one state high court:

> Where words used in a contract are susceptible of more than one meaning, and the signatories to the contract have by acts done in carrying out the terms thereof placed their own interpretation upon the meaning of the words, courts will adopt the interpretation which the signatories to the contract have themselves made.

Courtright v. Scrimger, 110 Ohio St. 547, 114 N.E. 294 (1924), paragraph two of the syllabus.

The reason for this general rule "has its origin in the presumption that the parties to the contract, at and after the making thereof, knew what they meant by the words used, and that their acts and conduct in the performance thereof are consistent with their knowledge and understanding, and that, therefore, their acts and conduct show the sense in which the words were used and understood by them." *Cincinnati v. Cincinnati Gaslight & Coke Co.* (1895), 53 Ohio St. 278, 287, 41 N.E. 239. Simply stated, "'[i]f a court is genuinely interested in what the parties to a contract meant, there is no surer way to find out ... than to see what they have done.'" *ACE INA Holdings, Inc.* at ¶33, quoting *Am. Home Prod. Corp. v. Liberty Mut. Ins. Co.*, 565 F.Supp. 1485, 1503 (S.D.N.Y. 1983) (internal citations and quotations omitted).

Moreover, in some jurisdictions, but not all, extrinsic evidence, including evidence of the parties' practical construction of a provision, may be used to determine whether a provision in an insurance policy is ambiguous. "Extrinsic evidence can become a consideration before an ambiguity has been identified from the face of the contract as a matter of law, in the limited sense that such evidence can assist the court in determining whether, as a matter of law, two plausible interpretations exist in the manner necessary to give rise to the existence of an ambiguity." *Lincoln Electric Co. v. St. Paul Fire & Marine Ins. Co.*, 210 F.3d 672, 684, n.12 (6th Cir. 2000) (Ohio law), superseded in part by *Goodyear Tire & Rubber Co. v. Aetna Cas. & Sur. Co.*, 95 Ohio St. 3d 512, (2002); *OneBeacon Am. Ins. Co. v. Bartley Marine, Inc.*, No. 04cv1934, 2005 U.S. Dist. LEXIS 34968 (W.D. Pa. Dec. 22, 2005) (Pennsylvania law); *Key v. Allstate Ins. Co.*, 90 F.3d 1546, 1548-49 (11th Cir. 1996) (Florida law); *Press Mach. Corp. v. Smith R.P.M. Corp.*, 727 F.2d 781, 784-85 (8th Cir. 1984) (Missouri law).

The 'Mutually Adopted' Requirement

The course of performance "must be conclusive and mutual to be probative." *B.F. Goodrich Co. v. Am. Motorists Ins. Co.*, No. C84-1224A, 1986 U.S. Dist. LEXIS 25205, *31-32, 1986 WL 191786 (N.D. Ohio May 22, 1986). "To have any value as a practical construction, the course of dealing should be uniform, unquestioned, and fully concurred in by both parties. A right claimed by one party, and from time to time denied or disputed by the other, though, for the time being, conceded, cannot, from such concessions, be regarded as established." *Id.*, citing *Cincinnati v. Cincinnati Gaslight & Coke Co.*, 53 Ohio St. 278, 286, 41 N.E. 239 (1895). *See also Eagle-Picher Indus., Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 12, 22 (1st Cir. Mass. 1982) (finding no error in exclusion of extrinsic evidence where "[w]hat was offered was a limited series of exchanges reflecting uncertainty, tentative positions, and compromise."); *Emp'rs Rein. Co. v. Superior Court*, 161 Cal. App. 4th 906, 924, 74 Cal. Rptr. 3d 733, 748 (2d Dist. 2008) ("Indeed, Chicago *expressly reserved* to itself the right to argue that the asbestos claims were not products claims, while it nonetheless paid them. For Chicago to now contend that its payment of those claims reflected a shared understanding with Thorpe that the claims *were* products claims is disingenuous at best.").

The mutuality requirement may be satisfied where one party has engaged in performance under a contract evidencing an interpretation of an ambiguous contract favorable to it, and the evidence shows the other party actually knew of the interpretation and has not objected to, but has acquiesced in, that interpretation. It is not required that the parties formally articulate their position so long as their mutual conduct evidences a particular interpretation placed on the contract provision. However, the requisite mutuality should not be found where one party has, presumably mistakenly, engaged in performance under a contract evidencing an interpretation unfavorable to it, and the other party does not object to the conduct, but acquiesces in it, to its own advantage.

A failure to object that is wholly self-serving and entails no detrimental reliance does not evidence a mutual understanding of the interpretation that should be given to the ambiguous contract. *See Shroeder v. Terra Energy*, 223 Mich.App. 176, 192-93, 565 N.W.2d 887 (1997) ("[W]hile generally a course of performance is highly persuasive evidence of proper contract interpretation when introduced against the party so performing, the law also recognizes that a party may undertake a wrong interpretation of the words of a contract and the other party should never be permitted to profit by such mistake in the absence of an estoppel arising from a prejudicial change of position in good-faith reliance on such performance.").

Thus, the clearest course-of-performance cases are those where performance by both the policyholder and its insurer are consistent with an interpretation that is challenged by another who is not a party to the contract, such as the underlying claimant or another insurer. In such cases, evidence of the mutual course of conduct of the actual parties to the contract can be very compelling.

An example is *Dicola v. Am. S.S. Owners Mut. Prot. & Indemn. Assn.* (*In re Prudential Lines*), 158 F.3d 65 (2d Cir. 1998). In *In re Prudential Lines*, underlying maritime asbestos claimants sought coverage for bodily injury claims from Prudential Lines' insurer, American Club, a nonprofit mutual insurance association of ship owners that wrote protection and indemnity coverage for its members, including Prudential Lines, which was bankrupt. The claimants disputed the number of occurrences arising from the asbestos claims, as it would affect the number of deductibles to be paid.

The Second Circuit began by noting that it was "not convinced that the deductible provision [wa]s ambiguous," but that even if it were, the parties to the policy intended American Club's interpretation, *i.e.*, that each asbestos claim was a separate occurrence. 158 F.3d at 79. The court observed that neither of the parties to the policy (Prudential Lines or American Club) ever proposed a single deductible for all asbestos-related bodily injuries aboard a particular ship; instead, both parties to the policy adopted varying multiple occurrence interpretations. *Id.*

Similarly, *Fed. Ins. Co. v. Americas Ins. Co.*, 258 A.D.2d 39, 691 N.Y.S.2d 508 (N.Y. App. Div.1999), concerned a situation where the policyholder and its auto insurer (Federal) acted in accordance with their mutual understanding that the Federal auto policy did not cover claims involving vehicles owned by a subsidiary company that had its own auto policies (issued by Westchester and Americas). In that case, the court found the mutual conduct of the parties to the Federal policy compelling evidence as to the construction of the Federal policy. Additionally, in *James v. Zurich-Am. Ins. Co.*, 203 F.3d 250 (3d Cir. 2000), after observing that "both parties to the contract say that the provision means 'X,' while a stranger to the contract — Meridian — says its means 'Y'[,]" the court found that "the consistent practical construction given to that provision by the parties to the contract controls its terms." In each of these cases, the mutual practical construction afforded by the actual parties to the insurance policy determined the meaning of the disputed ambiguous policy provision in question.

Also very persuasive is evidence of past course of performance by the *drafter* of the contract that adopted an interpretation it later seeks to avoid, such that the doctrine of *contra proferentem* would supply an additional basis for a decision that adopts such interpretation. Thus, although the law in many jurisdictions is that the rule of *contra proferentem* should be invoked as a "last resort," (*see, e.g., Eastern Air Lines, Inc. v. Ins. Co. of Pa.*, No. 96 Civ. 7113 (MGC), 2001 U.S. Dist. LEXIS 14734, *16, 2001 WL 1111514 (S.D.N.Y. Sept. 21, 2001)), it unquestionably is a factor that courts take into account. *See Cincinnati Ins. Co. v. ACE INA Holdings, Inc.*, 175 Ohio App.3d 266, 277, 2007-Ohio-5576, ¶41 (1st Dist.) ("Of course, if the policies are ambiguous — which they are — they should be construed against the drafter in any event. The persuasive evidence offered by CIC serves to ice the cake."); *see also Lomree, Inc. v. Pan Gas Storage, LLC*, No. 10-14425, 2011 U.S. Dist. LEXIS 88516, *12, 2011 WL 3498131 (E.D. Mich. Aug. 10, 2011) ("Since ¶15 is ambiguous, the Court considers the parties' course of performance *and* applies the rule of *contra proferentem*[.]" (Emphasis added)); *OneBeacon Am. Ins. Co. v. Bartley Marine, Inc.*, No. 04cv1934, 2005 U.S. Dist. LEXIS 34968, *16-17 (W.D. Pa. Dec. 22, 2005).

Thus, in cases where the rule of *contra proferentem* could have applicability, the drafter of the contract, should be held to its own conduct more so than another party which may be less familiar with industry practices. In the insurance context, of course, the insurer is almost always the drafter of the policy and will be more knowledgeable regarding insurance terminology and insurance industry practices. This, coupled with the duty of good faith an insurer owes to its policyholders and some courts' consideration of the reasonable expectations of the policyholder, means that evidence of an insurer's past course of performance will be found more compelling, and its acquiescence in a mistaken course of performance by its policyholder will be found less compelling, by many courts.

Conclusion

Evidence that the actual parties to an insurance policy engaged in a course of performance with regard to that insurance policy and gave ambiguous provisions therein a practical construction can be very compelling to a trier of fact. It is of little probative value, however, when a policyholder mistakenly engages in a course of performance against its own interest and its insurer, acting in its own self-interest, takes advantage of that misunderstanding by acquiescing in such performance. Counsel should be cognizant of these and other nuances in the applicability of course-of-performance evidence in order to best serve their clients in insurance coverage litigation.

Caroline Marks and **Keven Drummond Eiber** are shareholders in the Cleveland, OH, office of Brouse McDowell. They represent policyholders in connection with insurance coverage disputes of all types, including disputes regarding general liability, first-party property, directors' and officers' liability, professional liability, and crime insurance.