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Interpretation of Insurance Contracts Voice of Reason v Excessive Protection to Insureds

New Supreme Court Judgments in Israel

Recently, four different judgments were rendered by courts in Israel. All of them are greatly significant to the way Israeli courts interpret terms, conditions and exclusions in insurance contracts and also to the weight the courts give to the intention of the parties and the risks which insurers are willing to assume.

As the reader will observe from the short brief of these judgments, some of them are voice of reason from insurers' point of view, whilst others are, in our opinion, over protective for insureds or third parties.

Interpretation of Insurance Contracts Voice of Reason

A recent court judgment handed down by the Supreme Court* in **CA 453/11 M.S Aluminum Products Ltd. v Aryeh Insurance Co.** Ltd. – presents an unconventional challenge to the axiomatic application of the "contra proferentem" rule which has been adopted by Israeli courts for many years almost automatically in most insurance disputes. This means that whenever the insured disputed the interpretation of a specific term or clause, the court would prefer the interpretation which is in favour of the insured and against the Insurer, being the party who drafted the insurance contract.

This long standing principle reflects the courts' perception of the insurance contract as being a contract imposed by the insurer – the strong party – a modern-day "Goliath" on the insured being the small innocent and naïve party –"David".

In order to mitigate this perceived unfairness, the courts apply the doctrine of contra proferentem, (literally meaning – "against the one bringing forth"), giving the benefit of any doubt in favor of the insured, who had no real influence over the wording of the contract.

This specific claim was a claim under an Extended Fire Policy for losses due to the collapse of the building in which the insured's factory was located.

The insured alleged that the policy covers several eventualities of any kind of movement, and thus should be interpreted to include movement of land. The insurer alleged that the endorsement relates to certain eventualities of land movement.

The Supreme Court ruled that the interpretation of the insurer reflects the ordinary logical sense of the policy term, whilst the interpretation presented by the insured is illogical and extends the policy applicability to such a degree as to render the policy vague and boundless. Also, there is no place for the application of the "contra proferentem" rule, according to which the language of the insurance contract is interpreted most strongly against the insurer. The court determined that this rule should only be invoked if the positions presented by the insured and insurer are equally reasonable, however should not be applied where, in the first place, insurers' argument appears more reasonable than that of the insured. Significantly, the court rejected adoption in Israel of UK "reasonable expectation of the insured" rule.

Another positive Supreme Court precedent was handed down in September 2013 in **C.A 4675/13 Samrose Ltd. vs. Delvag Luftfahrtversicherungs – AG.**

This is a very significant case where all three court instances** which dealt with this case, refused to accept the insured's argument that the court should adopt the "contra proferentem" rule and construe the policy's terms in favour of the insured. Rather, all three instances ruled that the primarily rule of interpretation is that of logic when reading the policy as a whole.

The dispute in this case was in respect of a term in a Jewelers Block Policy which covers diamonds whilst being carried by the insured, provided that the diamonds (in excess of a certain amount) are carried on the body. The Body Warranty Clause does not apply in a "Hotel Premises". The loss occurred in the hotel's parking lot, and the insured argued that since the term "Hotel Premises" is not defined in the policy, it should be interpreted to include also the hotel's adjacent and secured parking lot.

The courts analyzed the policy terms and conditions and accepted insurers' position that the "Hotel Premises" should be construed as only the inner part of the hotel, where the risk of a robbery or theft is lower than from the moment the insured leaves the hotel premises even to walk to his car in the hotel's parking lot.

The Supreme Court emphasized that although the term was not defined in the policy, this conclusion is the only logical and reasonable conclusion when reading the entire policy. The court ruled that even in an all risks policy, there are limits to the risks that the insurer is willing to accept.

The Supreme Court emphasized that the most significant rule of interpretation is therefore the logical interpretation which would render the contract meaningful and which corresponds with the specific risk which the insurer agreed to take upon itself.

It is interesting to note that in this case, the lower court took into account the fact that the insured was a sophisticated insured who was assisted by an insurance consultant. This was a major factor in rejecting the insured's allegation that he did not understand the meaning of the term "Premises" in the policy.

Interpretation of Insurance Contracts Excessive Protection to Insureds

Almost simultaneously to these positive and encouraging new precedents, two other judgments were handed down, in which the courts ruled against an insurer. The common denominator of both decisions is the courts' consumer protective orientation.

One of these judgments was handed down by the District Court*** in Tel Aviv in FI liability insurance **C.C 48855-01-11 Marinyanski vs. Momentum Capital Markets et al.**

This was a claim by clients of a portfolio manager (the insured), alleging losses as a result of investments carried out by the insured in excess of authority. It was proven that the insured was fully aware of the fact that the investments executed in the portfolio constitute breach of the client's instructions. Significant losses incurred in the client's portfolio. In order to conceal the true situation from the client, the insured issued to the client false periodical reports which presented profits and concealed the breach of authority. The insured continued to invest the client's money in the same manner and as a result additional significant losses were created.

When the client found out about the true position, he filed a claim against the insured and his PI insurers.

Insurers declined coverage, inter alia, on the basis that the insured's acts were not negligent acts which are covered by the policy, but rather intentional and dishonest acts.

The Court applied a previous binding precedent of the Supreme Court in the case of C.A 2016/00 Anatoli Rosensweig v Rosenblit, and ruled that the policy covers the losses.

According to the Rosensweig precedent, an engineer is entitled to insurance benefits under his liability insurance, notwithstanding the fact that he knowingly deviated from a certain building standard in respect of the required amount of concrete. As a result of this deviation, cracks were created in the building. The Supreme Court held that since the insured neither intended to cause damage to his clients nor expected that such damage may be created, this does not constitute an intentional act.

In the matter of Momentum, the court applied the same principles, namely that since the insured did not intend to cause loss to his clients and since he did not receive an improper financial gain as a result of breach of the client's instructions, the insured's acts should not be deemed as "intentional acts".

In other words, according to this decision, dishonesty of the insured or intentional acts which are not covered under the policy, would be restricted only to cases where the insured intended to cause the damage or when proven that he was driven solely by anticipation of improper gain.

The decision is under appeal to the Supreme Court.

Note – we should add that in our opinion the court's decision is erroneous, inter alia due to the fact that the court disregarded few very important facts: 1. That the "improper gain" by the insured was his personal benefit from the fact that he continued to manage the client's portfolio as a result of concealment from the client of the real situation
2. That by investing the client's money in risky investments in direct breach of the client's instructions, the insured could have or should have expected that his acts would cause damage to the client. Such acts (which are similar to gambling) should be regarded as dishonest and willful conduct and it is therefore against public policy to insure such acts. The fact that the insured issued false periodical reports to the client is a significant fact which should have led the court to the conclusion that the policy does not cover such acts.

Another Judgment was handed down by the Supreme Court in the matter of **C.A 3260/10 Lloyds Underwriters v. Eliyahu Slutski.**

In this case, the policy issued by certain Lloyd's underwriters to cover the insured's apartment, included cover for the insured's jewelry. The policy was a renewal of previous policies and included a new term pursuant to which the jewelry must be kept in a safe, which the insured indeed had in his apartment.

The apartment was broken into and the insured's jewelry was stolen. The insured admitted that the stolen goods were not kept in the safe. Thus, the insurer declined policy coverage alleging that the insured breached the policy preconditions.

Three court instances heard this claim and the appeals filed by the parties.

The Supreme Court reached the conclusion that in the circumstances of this case the breach of the precondition in the policy by the insured does not negate his right for insurance benefits.

In its decision, the Supreme Court relied on specific provisions of the Insurance Contract Law which deal with the insured's duty to take measures to reduce the risk of the insurer, and the remedies available to the insurer in case of breach of such duties. Pursuant to these provisions, the insurer does not have an automatic right to avoid payment of insurance benefits in each case where the insured did not adhere to the security measures.

The Court ruled that if we apply the reasoning of the relevant provisions of the Insurance Contract Law, the fact that the jewelry was kept outside the safe cannot exempt the insurer from liability under the policy but rather that the proportionate liability principle should apply.

According to this principle embodied in section 21 of the Insurance Contract Law, in case the insured fails to implement policy condition aimed at materially alleviating insurer's risk, then if the risk eventuates, the insured may still be entitled to partial insurance benefits. The formula for determining the rate of indemnification imposed on insurers is the ratio of premium actually charged and that which would have been charged by the same insurer had the insurer been aware of the true position. An insurer may be discharged of all liability only in case of fraud by the insured or if no other reasonable insurer would have undertaken the risk, even for higher premium, had such insurer been aware of the true facts.

In view of the fact that the insurer in this case did not prove any of the above, the Supreme Court ruled that the insured is entitled to full insurance benefits.

Note – In this case insurers not only failed to prove that no reasonable insurer would have underwritten the risk even for higher premium but also that the specific insurer who issued the policy would not have charged additional premium had he been aware of the breach. In view of this predicament, some insurers may now wish to consider, in the first place, offering two insurance alternatives: 1) assumption of the risk with protective measured for "normal" premium and 2) without protection measures for a much higher premium – for example triple premium. In case of loss as a result of no implantation of the protection measures, insurers would then have conclusive proof that they are only liable for 1/3 of the loss

*The Supreme Court is the highest instance in Israel and its decisions are bindings on all lower courts.

** In Israel, the losing party has an automatic right to file an appeal to the higher court (appeal on judgments handed down by the Magistrates courts are filed to the District Courts and judgments handed down by the District Courts are filed to the Supreme Court). The Supreme Court judgment is final and cannot be appealed. However in very rare cases, the Supreme Court grants an additional review but only when the decision has a significant and important impact to many cases and a novel point of law is involved.

*** The decisions of the District Court, which is the second court instance, are not bindings but only serve as guidance to lower Magistrates courts